Media Release:

Aerospace Industrial Development Corp 'twAA/twA-1+' Ratings Affirmed; SACP Revised Upwards On Improving Debt Leverage; Outlook Stable

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Rating Action Overview

- **Aerospace Industrial Development Corp. (AIDC)** is the sole supplier/coordinator for Taiwanese air defense projects and provides Taiwan's self-developed aircraft. The company also engages in commercial aviation business, providing aircraft parts and engine parts for global aircraft and engine manufacturers. AIDC generated revenue of new Taiwan dollar (NT$) 39.10 billion and EBITDA of NT$5.15 billion in 2023.
- AIDC has improved its debt leverage in 2023. This is thanks to the company's business recovery and enhancement on working capital management, particularly in improving accounts receivable turnover days from the Taiwan government. We do not view AIDC's higher working capital outflow to significantly raise the debt leverage over the next two years. As a result, we raised the company's stand-alone credit profile (SACP) to 'twbbb+' from 'twbbb'.
- We expect AIDC to maintain its revenue contribution from advanced jet trainers project until 2026. This is despite a likelihood of higher working capital outflow during the mass production period.
- We have affirmed our long-term issuer credit rating on AIDC at 'twAA', and short-term issuer credit rating on 'twA-1+'.
- The stable rating outlook reflects our view that AIDC's ratio of debt to EBITDA will maintain at around 2x - 3x with higher volatility over the next two years.

Rating Action Rationale

Ongoing projects from the Taiwanese military remain as primary source of cash flow generation. The Taiwan government has budgeted NT$68.6 billion for 66 units under the advanced jet trainer project, which is now in mass production, with delivery to peak during 2023-2026. In addition, the improvement project for F-16 was fully completed in 2023. These projects, together with its recurring and rising maintenance and repair service for military, helped the company to boost revenue in 2023, with a 30% of revenue growth in its military aircraft business. However, We expect AIDC's revenue momentum in its military aircraft project business to slow down over the next two to three years. This is due to the F-16 upgrading project that was fully completed in 2023.

Although the revenue mix of AIDC on military business (48% of its revenue in 2023) is similar to that of its commercial aviation business (42%), the gross margin of the company's military business is still stronger and more stable than that of its commercial aviation business. As a result, AIDC's profit and cash flow generation is still mainly from the military aircraft business. In addition, in light of cross straits tension, we estimate the company will continue to receive new defense-related orders from the Taiwan government over the next three to five years. Notably in maintenance and repair services for newly upgraded F-16 and advanced jet trainers.

A strong recovery in demand of global air-traveling helped AIDC improve commercial aviation business, but the margin improvement remains sluggish. The company's revenue from engine parts and aircraft parts have increased by 18.5% in 2023, thanks to the strong recovery in air traffic during the post-pandemic period. AIDC's gross profit margin of commercial aircraft engine-related business improved to 12.5% in 2023, compared to 6.7% during the pandemic. However, the profitability of its aircraft parts business continues to struggle in 2023 due to high air freight costs. We expect AIDC profit margin improvement to remain moderate over the next one to two years, despite the company's commercial aviation business should recover over the same period.

Financial leverage improved thanks to business recovery and enhanced working capital management. Favorable operating conditions helped AIDC generate stronger revenue and EBITDA in 2023. The company's revenue increased by 29% year-on-year in 2023, while EBITDA grew by 69% over the same period. This is supported by the company's efforts to manage working capital, especially for account receivables, mainly through government-related projects and acquired payments for the advanced jet trainer project. As a result, AIDC's ratio of debt to EBITDA improved to 2.2x in 2023, from 4.7x in 2022. Nonetheless, the company's cash flow generation is highly linked to government jets project, which could lead to higher volatility of cash flow and debt leverage. Accordingly, we expect AIDC to maintain the ratio of debt to EBITDA at 2x-3x over the next two years.

Outlook

The stable rating outlook on AIDC reflects our expectation that the company's ratio of debt to EBITDA could remain at 2x-3x over next two years. The following factors will support the improvement: AIDC's new advanced jet trainer project for the Taiwan government, mass production deliveries of which will occur in 2024-2026; the recurring business from the maintenance and repair of military aircraft; and the post-pandemic recovery in the commercial aircraft-related businesses.

The stable outlook also reflects our expectation that AIDC's role and link with the Taiwan government will remain intact over the next one to two years.

Downward scenario

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

- The company's debt to EBITDA ratio stays materially above 5x over the next two years. This could result from lower-than-expected cash flow generation given that the potential risk of supply chain disruption and bottlenecks could decelerate the recovery on global commercial aircraft sales and deliveries, which might impact on the inventory and account receivable level; or
- The company incurs large losses, particularly in its business development in manufacturing parts and components for commercial aircraft, which results in a material deterioration in the company's profit margin and cash flow.

Upward scenario

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

- The company could maintain the ratio of debt to EBITDA close to around 2x on a sustainable basis. This could happen if the company could improve its business momentum in military aircraft business after the delivery of advanced trainer jets in 2026; and
- The company continues to improve its cash conversion cycle with more effective accounts receivable management and better inventory control on a sustainable basis.

Our Base Case Scenario

- S&P Global's forecast for Taiwan's GDP growth is 3.0% in 2024 and 2.6% in 2025. In terms of global GDP growth, S&P's expectation is 3.2% in 2024 and 3.3% in 2025.
- We view the global air traffic will continue to rise and demand to remain strong in 2024. This is despite the slowdown of economic conditions.
- Aircraft production and deliveries will increase. Boeing will increase MAX production and deliver its inventory of finished planes, and Airbus will keep increasing production of its A320 family.
- Airlines are expanding fleets to meet stronger demand; however, supply chain and labor constraints and manufacturing defects persist. Several new engines are seeing lower time-on-wing performance, reflecting the tradeoffs and diminishing returns of engineering advances.
- Taiwan government has budgeted NT$68.6 billion for T-BE5A advanced trainer jet program until 2026, NT$2.3 billion and 5-year contracts for F-16 maintenance service and several military projects.
- AIDC's revenue is expected to slightly drop by 0.5%-1.5% in 2024, due to the completion of F-16 upgrade project in 2023, which could slightly lower the revenue from military businesses. However, we believe AIDC's overall revenue growth will resume in 2025, increased by 1.5%-4.0%. Given that, the commercial aircraft businesses will continue to recover over the same period.
- AIDC continues to produce and deliver the T-BE5A advanced trainer jet to Taiwan's Air Force during 2024-2026. This military aircraft projects will be one of the company's major income sources and support its revenue. However, revenue from those projects is going to gradually lower down during over the same period. This is because the delivery is expected to be completed in 2026.
- We believe the revenue from maintenance and repairing services on military aircrafts will continue to grow as the demand from Taiwanese Air Force, especially for F-16 and T-BE5A fleets, is still growing due to geopolitical tension over the next two years. AIDC is the exclusive maintenance servicer of the newly upgraded F-16 fleet and T-BE5A advanced jet trainer fleet in Taiwan, which could support the revenue growth.
- Revenue from commercial aircraft's engine related will have a double-digit growth in 2024-2025 as the growing demand for commercial aircrafts in post-pandemic period.
- AIDC to face losses of negative 6%-11% on the gross profit margin in 2024-2025, from commercial aircraft parts business, and will gradually improve to negative mid-to-low single digit over the longer term. The still high freight cost might impact the gross profit margin of commercial aircraft parts businesses, and we believe AIDC still need some time to adjust its final price for its products.

- Capital expenditure (capex) will be NT$600 million-NT$700 million in 2024-2025, and NT$100 million-NT$200 million in 2026. This also includes the equipment upgrade project for the production of GE Leap 1A's parts in 2024-2025.
- Several cash outflow likely from working capital in 2024-2025, due to the mass production of T-BE5A, which might have some inventory for the projects. The company to have more regular AR collection for the T-BE5A projects in the next two years.
- 60% of cash dividend payout ratio over 2024-2025.

Key metrics

Aerospace Industrial Development Corp. -- Forecast Summary

Industry sector: Aerospace and defense

	--Fiscal year ended Dec. 31--					
(Mil. NT$)	**2021a**	**2022a**	**2023a**	**2024e**	**2025f**	**2026f**
Revenue	23,735	30,242	39,100	38,651	39,391	40,801
EBITDA (reported)	1,935	2,921	4,270	4,067	4,145	4,403
Plus/(less): Other	583	130	880	880	880	880
EBITDA	2,518	3,051	5,150	4,947	5,025	5,283
Less: Cash interest paid	(111)	(144)	(263)	(183)	(177)	(173)
Less: Cash taxes paid	(102)	(120)	(418)	(543)	(557)	(614)
Funds from operations (FFO)	2,305	2,787	4,469	4,221	4,291	4,496
Cash flow from operations (CFO)	4,577	2,469	4,664	1,182	4,621	4,523
Capital expenditure (Capex)	1,247	591	1,155	660	660	150
Free operating cash flow (FOCF)	3,330	1,878	3,508	522	3,961	4,373
Debt (reported)	17,461	16,133	14,391	12,343	12,077	12,077
Plus: Lease liabilities debt	1,744	1,646	1,552	1,463	1,379	1,300
Less: Accessible cash and liquid Investments	(3,328)	(3,331)	(4,653)	(1,000)	(2,600)	(4,845)
Debt	15,876	14,448	11,290	12,806	10,856	8,532
Cash and short-term investments (reported)	3,328	3,331	4,653	1,000	2,600	4,845
Adjusted ratios						
Debt/EBITDA (x)	6.3	4.7	2.2	2.6	2.2	1.6
FFO/debt (%)	14.5	19.3	39.6	33.0	39.5	52.7
Annual revenue growth (%)	12.8	27.4	29.3	(1.1)	1.9	3.6
EBITDA margin (%)	10.6	10.1	13.2	12.8	12.8	12.9

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--actual. e--estimate. f--forecast. NT$-- new Taiwan dollar.

Liquidity

The short–term rating on AIDC is 'twA-1+'. We assess AIDC's liquidity as adequate because we believe the company has sufficient cash flow to meet its needs over the next 12 months factoring in state-owned bank facilities. We expect the ratio of AIDC's liquidity sources to uses to be 1.25x to 1.35x in the 12 months ending December 2024. Furthermore, we believe the company will have sufficient liquidity headroom even if its forecast EBITDA declines by 15%.

In addition, we believe AIDC has well-established relationships with banks and could establish new credit facilities when needed. This is supported by its a government related entity status, as evidenced by the company's sufficient borrowing facilities from government-related bank. We believe AIDC has generally prudent risk management to ensure at least adequate liquidity, because the company's operational and financial budget needs to be approved by the Ministry of Economic Affairs and remains under the government's surveillance. The company's loans carry no financial covenant.

Principal liquidity sources:

- Cash and short-term investments of NT$4 billion–NT$5 billion at the end of 2023.
- Funds from operations of NT$4.5 billion–NT$ 5.5 billion in 2024.
- Ongoing government support in the form of government-related bank facilities of NT$10.5 billion–NT$ 11.5 billion to cover refinancing needs in 2024.

Principal liquidity uses:

- Debt maturities of NT$10 billion – NT$11 billion in 2024.
- Expected working capital outflow of NT$3.5 billion–NT$ 4.5 billion in 2024.
- Capex of NT$0.5 billion–NT$1.0 billion in 2024.
- Cash dividend payout NT$1.0 billion–NT$ 1.5 billion in 2024.

Rating Scores Snapshot

Aerospace Industrial Development Corp		
	To	**From**
Issuer Credit Rating	twAA/Stable/twA-1+	twAA/Stable/twA-1+
Business risk	Fair	Fair
Country risk	Intermediate	Intermediate
Industry risk	Intermediate	Intermediate
Competitive position	Fair	Fair
Financial risk	Significant	Aggressive
Cash flow/Leverage	Significant	Aggressive
Anchor	twbbb+	twbbb
Modifiers		
Diversification/Portfolio effect	Neutral (no impact)	Neutral (no impact)
Capital structure	Neutral (no impact)	Neutral (no impact)
Financial policy	Neutral (no impact)	Neutral (no impact)
Liquidity	Adequate (no impact)	Adequate (no impact)
Management and governance	Neutral (no impact)	Neutral (no impact)
Comparable ratings analysis	Neutral (no impact)	Neutral (no impact)
Stand-alone credit profile (SACP)	twbbb+	twbbb
Sovereign rating	AA+	AA+
Likelihood of government support	Very high (+5 notches from the SACP)	Very high (+6 notches from the SACP)
Note: The descriptors are on a global scale.		

Related Criteria & Research

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- General Criteria: National And Regional Scale Credit Ratings Methodology - June 08, 2023
- 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: 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 – Nov. 11, 2021

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

Ratings List

Ratings Affirmed

Aerospace Industrial Development Corp.	
Issuer Credit Rating	twAA/Stable/twA-1+