

Research Update

Aerospace Industrial Development Corp. Ratings Affirmed At 'twAA-/twA-1+'; Outlook Stable

June 5, 2019

Rating Action Rationale

Taiwan Ratings Corp. today affirmed its 'twAA-' long-term and 'twA-1+' short-term issuer credit ratings on **Aerospace Industrial Development Corp.** (AIDC). The outlook on the long-term rating is stable. The ratings on AIDC continue to reflect the company's monopoly role providing self-developed aircraft to Taiwan's military with sustainable business from the maintenance of such aircraft, the government's policy to increase self-sufficiency in airborne defense, as well as the relatively stable performance of AIDC's commercial engine business. In addition, we continue to view the company to receive a very high likelihood of extraordinary financial support from the Taiwan government. Tempering these strengths are the company's relatively small scale and limited projects on hand, high client concentration with strong customer bargaining power, AIDC's expansion in loss-making commercial aviation component parts business, and high debt leverage.

Outlook

The stable outlook reflects our expectation that AIDC will achieve slight improvement in its debt to EBITDA ratio to close to 4.5x over 2020-2021, from about 5x as of the end of 2019. This is supported by the company's strong position as Taiwan's major supplier of self-developed defense aircraft, the recurring business from the maintenance and repair of these aircraft, and the increasing contribution from its aero engine business with relatively stable and good margin. The assessment of an improved debt to EBITDA ratio also reflects our expectation of some cash inflow due to moderate improvement in AIDC's receivable turnover days.

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

Downward scenario

We could lower the rating if the company's debt to EBITDA ratio stays materially above 5x. This could happen if AIDC's cash conversion cycle further deteriorates, resulting in a larger cash outflow than we previously expected due to strong bargaining power from its downstream clients. This could also happen if the company incurs large losses particularly in its business development in manufacturing parts and components for commercial aircraft, or faces more intensified competition that results in a material deterioration in AIDC's profit margin and cash flow.

The ratings will also come under pressure if we believe that the company's role to and link with the Taiwan government has weakened substantially, which includes:

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- A substantial reduction in government ownership, such as to less than one third of total ownership, or the government gives up control of AIDC's board.
- A change in government policy such that the government chooses to materially lower its self-sufficiency on air defense, and instead purchases aircraft from primarily outside of Taiwan.

Upward scenario

We could raise the long-term rating if AIDC could keep its ratio of debt to EBITDA below 4x. This could happen if the company improves its cash conversion cycle with more effective accounts receivable management. This could also happen if over the next two to three years the company could improve its EBITDA and cash flow materially during the major delivery period of the next generation jet trainer.

Rating Score Snapshot

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

Note: All scores are in comparison with global obligors.

Business risk: Fair

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

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: twbbb

Modifiers

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

Stand-alone credit profile: twbbb

- Sovereign rating: AA-
- Likelihood of government support: Very high (+5 notches from the SACP)

Related Criteria

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Aerospace And Defense Industry - March 25, 2014
- General Criteria: Methodology: Industry Risk - November 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com - June 26, 2018
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

- General Criteria: Group Rating Methodology - November 19, 2013

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Ratings List

Ratings Affirmed

Aerospace Industrial Development Corp.

Issuer Credit Ratings

twAA-/Stable/twA-1+

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