

Aerospace and Defense Industry - Key Success Factors

The key success factors apply to a corporation engaging in the aerospace and defense-related industry.

BUSINESS RISK ASSESSMENT

Competitive Advantage

The analysis covers the assessment of the company's ability to maintain its market position, business stability, and competitiveness, which can be reflected by the following factors:

- Market presence across product segments and regions, and ability to defend or grow market share.
- Product and market attractiveness, value proposition, and pricing competitiveness.
- Competitive standing relative to peers, including barriers to entry and strategic positioning.
- Brand awareness and brand equity, covering customer loyalty, quality perception, and historical track record.
- Growth indicators from production, sales, and market demand.
- Unique selling points that enhance differentiation.
- Resilience to economic cycles, cost volatility, regulatory changes, and substitution risks.
- Raw material procurement reliability and cost efficiency.
- Technology leadership and competency. The analysis covers a comprehensive assessment of the company's contracting and technology capability, patents, and technology under development to ensure the company's ability to deliver service or production in a timely manner given the fact that the nature of some of the customer's contracts is such that cost overruns and delays are covered by the contractor, which could lead to a significant cash impact if the programs run into trouble. Therefore, a track record of successful program execution and good project management tend to be rated higher. We also assess the company's ability to integrate complex technology into its products or services. We further consider the company's competency level on licenses, certifications requirements in the industry, and qualified human resources for its services and products. A company's history and commitment to innovation and development of new technologies, which are key to maintaining market leadership positions, are also assessed.

Diversification

The analysis includes risk assessments on the company's ability to stabilize overall operating performance and cash flows through diversification of its products or market, leading to improved credit protection measures, based on following assessments such as:

- Products offered, customer base, and sales areas, reflecting the breadth and diversity of markets served.
- Production facilities and geographical operating areas, indicating the company's operational footprint and coverage.
- Diversity of customers and buyers, composition of domestic and export markets, and dependency on key counterparties across the supply chain.
- Proportion of recurring and contract-based revenue, payment reliability of counterparties, and overall stability and predictability of cash flows.

Operating Management

The analysis assesses the company's cost position advantages and operating management, as reflected in its profitability, management quality, and working capital or budgetary control. It covers the following key indicators:

- The analysis of profit margins, particularly EBIT and EBITDA margins, including the comparison with other players in the same industry or other industry with similar characteristics.
- Working capital management and the comparison with other players in the same industry or other industry with similar characteristics.
- Capability, commitment, and experience of the company's management on achieving the target, compliance, environmental and social issues.

FINANCIAL RISK ASSESSMENT

Financial Policy

It is important to understand the management's philosophy and strategy toward financing decision (historical, current, and future). The aggressive financial policy will carry higher financial risk as opposed to conservative financial policy with lower financial risk. The analysis includes a review and examination of:

- Management's financial targets including growth, leverage, debt structure, hedging and dividend policy
- Debt structures and composition (rupiah vs. foreign currencies, short-term debt vs. long-term debt, fixed rate vs. floating rate)
- Track record on fulfilling its previous financial obligations to determine the degree of its commitments and willingness and consistency to pay obligations on a timely basis
- Other policies to reduce the company's overall financial risk (historical vs. future)

Capital Structure

We are of the view that the debt obligation level in relation to earnings and capital condition is the fundamental part of a company's financial risk profile. The analysis covers careful examination of the company's historical, current and projected leverage, indicated mainly by total and net debt in relation to EBITDA (Debt-to-EBITDA) and equity (Debt-to-Equity).

Cash Flow Protection and Liquidity

The pattern of current and future cash flow generation is also one of the most vital indicators of a company's financial risk. The analysis covers reviews of the company's cash flow generation and capability to meet its short-term and long-term financial obligations, mainly measured by:

- Debt coverage ratio (Funds from Operation to Debt)
- Interest coverage ratio (EBITDA to Interest)

The degree of its liquidity in fulfilling its short-term liabilities relative to its sources of cash is also assessed. The sources of cash include:

- Cash balance
- Estimated cash flow from operations
- Other sources of cash

Under some circumstances, liquidity attains such primacy that it alone constrains a company's credit rating, leaving other credit drivers as a secondary indicator even if supportive. This follows from our view that to succeed in the long term, a company first needs to survive in the short term.

Financial Flexibility

Financial flexibility is an essential factor for a company to carry out its operating activities and/or refinance existing borrowings regularly at short notice. We are of the view that a strong financial flexibility will enhance a company's credit profile as it might partially mitigate liquidity risk, while a weak financial flexibility could underwhelm a company's credit profile despite having decent credit ratios. The analysis covers evaluation of the company's capability in raising funds, including options under distress, contingency plans, and flexibility to deal with various adverse scenarios. Analysis includes other related factors or figures that are not specifically examined above, such as:

- Banking relationship
- Experience and track record in debt and capital markets
- Covenants' compliance in loan/bond agreements
- Parental/shareholders' commitment and support
- Unused credit facilities (committed and uncommitted)
- Unpledged assets

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