

HBC credit rating downgraded, but not all news is bad

by Kirby J. Harrison

Hawker Beechcraft Corp. (HBC), like other business aircraft manufacturers, is struggling with markets that are smaller than anticipated. It is also continuing to adjust to markets that “dictate higher costs, lower production rates and an even more highly skilled workforce,” HBC chairman and CEO Bill Boisture told AIN.

While Boisture’s assessment appears accurate, there are also signs that Hawker Beechcraft remains stuck, not between a rock and a hard place, but between a hard place and a harder place.

And while some of the Wichita-based OEM’s problems have their source in the current recession, others are more than a decade in the making, well before Boisture began his tenure at HBC in 2009.

When Raytheon Aircraft (HBC’s parent company at the time) announced launch of the Hawker Horizon program in 1996, the new super-midsized jet’s first flight was expected in 1999, and certification and deliveries were to begin in 2001. It was the company’s first venture into this market. Then-president Roy Norris described the Horizon as filling the gap between the \$11 million Hawker 800XP and the \$20 million Challenger from Bombardier. With the name later changed from Hawker Horizon to [Hawker 4000](#), it was to be the company’s flagship.

The result is, by most accounts, an excellent airplane—all that was promised and more. But certification issues plagued the aircraft’s development, and the first delivery was an unprecedented eight years late. By the end of last year’s third quarter Hawker had delivered only forty-three 4000s since the airplane received full certification in late 2008.

According to Boisture, before the airplane received final FAA approval, Hawker Beechcraft had a number of completed airplanes on the ramp awaiting customer delivery. He characterized deliveries in 2010 and 2011 as “stable.” According to numbers

compiled by the General Aviation Manufacturers Association, twenty 4000s were delivered in 2009, 16 in 2010 and seven in the first three months of last year.

Hawker Beechcraft blames the recent slowdown in deliveries, in part, on delays in FAA certification of the critical Load 20 software upgrade from Honeywell. The FAA awarded that certification in August 2011; EASA certification followed in November.

Even with delays in both the Hawker 4000 and Premier I certification, the company was riding the wave of unprecedented market demand for business aircraft in the mid-2000s. Things then only looked good.

At the NBAA Convention in 2006, Raytheon announced orders for 112 airplanes valued at nearly \$1 billion. The same year, the company broke ground on a \$16.3 million, 112,000-sq-ft expansion to support Hawker 4000 interior completions. At the same time, production had ramped up on the T-6 trainer as part of a multi-billion-dollar program that would require delivery of 800 airplanes through 2017. But that was before the recession, and things have rapidly gone downhill since.

The company reported its [2011 third-quarter earnings on November 1](#), and there was little to cheer in those numbers. Net sales for the third quarter were \$518.8 million, a decrease of \$75.9 million for the same period in 2010. The company delivered 38 civil airplanes in the third quarter, 11 fewer than in the same period in 2010, and the total backlog value had dropped from \$1.4 billion to \$1.3 billion.

Shortly after, on November 4 in a letter to employees, Hawker Beechcraft announced yet



another round of layoffs. Boisture described it as part of the company’s efforts to resize in the face of a continuing recession. “We didn’t just reduce employment; we reduced it with good reason, as we’ve been doing since 2009, rapidly and then gradually in increments as we size our company to what we think the new long-term market will be.”

The layoffs were to affect 300 workers.

More bad news followed before the end of the month when the U.S. Air Force notified Hawker Beechcraft that it [had been disqualified from bidding on a billion-dollar contract for an upgraded light attack airplane](#).

The company has requested a review of the bidding process with the Government Accountability Office “to find out where we stand and why.”

Boisture, a former fighter pilot and U.S. Air Force Academy graduate, described the Air Force’s decision as a surprise, “particularly in light of the fact that the AT-6 [a light attack version of the T-6 trainer] was developed in concert with Air Force requirements, many of which we helped create,” he said.

Another casualty in the Hawker Beechcraft struggle—at least for now—came with the [announcement](#) on December 2 that the [Hawker 200 program](#)—née the Premier I and

subsequently the upgraded Premier II—was put on hold. In a letter to employees, Boisture emphasized that the light twin-jet had “met or exceeded all performance objectives in the flight-test program and market acceptance has been impressive.”

However, he added, “given the fragile global economic situation and its impact on the current and forecasted light-jet segment, we have determined that the prudent management decision is to slow the pace of the completion of the Hawker 200 certification program until indicators reflect a healthier light-jet market.”

Credit Rating Downgraded

If the business aviation industry is watching Hawker Beechcraft, so is the financial industry, and closely. In September, Moody’s Investment Service downgraded HBC’s credit rating from Caa2 to Caa3. The decision, according to Moody’s analyst Edwin Wiest, reflects the company’s “mounting retained deficit and our view that the soft economy dims chances for profitability anytime soon.” Wiest noted that cash fell from \$423 million on Dec. 31, 2010, to \$143 million by June 30, 2011.

Boisture objected, saying that the analysis did not consider a broader revenue base, including continued growth of the company’s Global Customer Support service, global sales of the T-6 trainer and its AT-6 and demand for special-missions solutions through products like the [King Air 350ER](#). However,

Deliveries of Hawker’s flagship 4000 slowed as a result of delays in FAA certification of the airplane’s Load 20 software.

the international market for the AT-6 appears uncertain. On one hand, Boisture pointed out that defense budgets around the world are shrinking, but at the same time, there remains a requirement for a light-attack aircraft to deal with limited conflicts in an efficient way.

On December 1 Standard & Poor’s cut its own credit rating of HBC to Caa3, saying the manufacturer may be facing a distressed debt restructuring. That announcement was followed less than a week later by actions among bond dealers who began offering 24 cents on the dollar for the company’s \$182.9 million of 8.5-percent notes due in April 2015.

The downgrades also served to focus a spotlight on Hawker Beechcraft’s \$2.14 billion of outstanding debt (as of Sept. 30, 2011), leading observers to question whether a debt restructuring is in the offering.

After the announcement of the Standard & Poor’s downgrade, HBC issued this statement: “We are entering a phase of our business during which we will likely need to address our revolving credit agreement which was last amended more than two years ago. To do this in a timely and effective manner, we are retaining the services of a highly respected consulting and financial services firm, Perella Weinberg Partners, to augment our finance team in business

plan development and general corporate advisory services.

“The retention of world-class financial advisors is one more step in our efforts to provide a good foundation for Hawker Beechcraft and a sustainable and profitable future,” the announcement concluded.

According to Boisture, the term-debt is something the company is planning for. “When you approach a juncture like that, you do so with a clear focus on continuing to make the enterprise more valuable than it was in 2007 when it was purchased.”

It should come as no surprise that HBC’s problems have promoted speculation that the company is for sale. “Every private-equity-owned company is, at some point, for sale,” said Boisture. “It’s what private-equity people do, but is Hawker Beechcraft for sale? Not really. Why would our owners elect to sell now at the bottom of the cycle? They’re both strongly capitalized and adequately capitalized without liquidating their Hawker Beechcraft holding. They have no need to sell.”

It’s a reasoned opinion echoed by aviation industry analyst Richard Aboulafia of Fairfax, Va.-based Teal Group. “I don’t know why anybody who plans to sell would do so at the bottom of the market, and that’s where we are,” he said. “If you sell, it’s either because you don’t think things are going to get any better, or because you need the money. I don’t think this is the case with Onex Partners and Goldman Sachs.”

Not All the News Is Bad

Nevertheless, amid all the bad news and speculation, there is cause for optimism. “A lot of the news is not about Hawker Beechcraft,” said Boisture, “but about the market, and that market is affecting everyone.”

After several years of watching mostly bad news emerge from Pandora’s economic box, HBC, like others, is looking outside the U.S. market for hope.

“We are encouraged by what we see in parts of Latin America, Russia and Africa,” explained Boisture. He added, the political unrest and violence could accelerate a need for multi-role and special-mission aircraft for such jobs as counter-terrorism, surveillance and border patrol. HBC is promoting its AT-6, as well as special-mission versions of the

King Air line, in such roles.

In addition, the company takes a positive view of many of the actions—layoffs, product delays, cost-cutting measures, outsourcing work to local vendors and moving jobs to Mexico—that seem to indicate gloom. These actions were all “positive steps” to size the company to match market demand, Boisture explained.

Included in those steps is an incentive agreement reached last December with the state of Kansas. It called for the manufacturer to maintain its current production lines and to retain at least 4,000 jobs over the next 10 years.

In return, the \$40 million incentive deal includes \$10 million over three years for tuition reimbursement and training. Another \$10 million in the first year and \$5 million for the following four years is part of its

HBC took a number of “positive steps” to right-size the company to match market demand.

—HBC chairman and CEO
Bill Boisture

Major Project Investment to be used for such costs as purchase or relocation of equipment, product development, labor recruitment or building. Some might see the deal as a handicap.

It is “absolutely not a handicap,” said Boisture, who pointed out that as a result of the agreement, HBC currently has 250 people in continuing education. “We can flex the workforce under this agreement and cross-train people for multiple skills, which is a huge benefit. The accountability is not a burden,” he said. “It’s a huge benefit and I’m glad we did it.”

Also a plus was the company’s 2010 decision to restructure Hawker Beechcraft Services and bring services and support all under a new umbrella—Global Customer Support (GCS). Year-over-year sales figures showed sales for the GCS segment for the first three months of 2011 of \$387.5 million, an

increase of \$1.7 million for the same period in 2010.

The King Air line, with frequent upgrades, has been a steady source of revenue for HBC, with 54 deliveries in first nine months of 2010 and 55 deliveries for the same period last year. In 2011, King Air special-missions orders included those from: the Colombian Air Force, Aviation & Applied Ecology of Moscow and Armed Forces of Malta.

“The market for the 350 encourages us to consider building more of them,” Boisture said. “And the other two King Airs are fine at the current rate of production.”

Moving Away from Wichita

While the company is still cutting costs in Wichita and has reduced its total footprint by around a million square feet, it is expanding its lower cost operations in [Chihuahua, Mexico](#), where the facilities now total 500,000 sq feet and employ 1,000 workers.

“The initial and largest part of the outsourcing has been completed, the manufacture of thousands of parts has been transferred from Salina and Wichita and the flow of parts is growing,” Boisture said. “There were issues [with the Mexico facility] earlier in the year that interrupted the flow of parts to the King Air line, but the team has worked through it and we’re on a track to minimize and then eliminate the effect on our business.” The company will undertake more outsourcing late this year.

Also on the positive side of the ledger was an [agreement reached in August with the machinists union](#) for a five-year contract. The migration of jobs to outside vendors and to the company’s Mexico facility had previously been a sticking point.

On the whole, Boisture said he expects Hawker Beechcraft to be “pretty well in balance with the market by the end of 2011” and this would be apparent when the company releases its 2011 earnings statement. “We will go into 2012 with both feet on the ground with a balanced strategy for 2012,” he concluded. □

