

## **Outlook On Auckland International Airport Revised To Stable On Announcement Of NZ\$454 Million Capital Return; 'A-/A-2' Ratings Affirmed**

SYDNEY (Standard & Poor's) Dec. 3, 2013—Standard & Poor's Ratings Services today revised its outlook on Auckland International Airport Ltd. (AIAL) to stable from positive, and affirmed its 'A-/A-2' ratings on the company.

“The outlook revision follows AIAL's announcement that it intends to undertake a NZ\$454 million capital return, expected to be completed by mid-April 2014, which will be largely debt funded,” said credit analyst Thomas Jacquot. “The increase in debt will drive a relative weakening of the key financial metrics over the short term, in relation to our prior expectations, although this deterioration is not severe enough to result in the ratings being under downward pressure.”

The stable outlook is based on Standard & Poor's view that AIAL's financial metrics will remain at above 15% and 3.5x for FFO to debt and FFO cash interest coverage, respectively. This is despite the recent announcement that the company intends to implement a capital reduction of NZ\$454 million in April 2014. The outlook also reflects our view that AIAL will maintain its excellent business-risk profile.

AIAL's rating could be under pressure if its financial performance deteriorates to the point whereby we would expect FFO to debt to drop below 12% or FFO interest coverage below 2.5x on a sustained basis. This could occur in the following scenarios:

- AIAL increases its expected capital-expenditure program over the next two-to-three years, which would result in debt levels being higher than our expectations;
- AIAL undertakes acquisitions that would materially affect its financial metrics or business profile; or
- There were materially adverse regulatory developments that resulted in significant uncertainty as to AIAL's ability to earn an adequate return on its assets and future aeronautical investments.

“We believe that the recent capital return provides a clear signal about the company's capital management and that therefore any future financial performance upside is likely to ultimately be returned to shareholders,” said Mr. Jacquot. “As such, any upside in the rating would not only require significant improvement in financial metrics (such as FFO to debt consistently above 18%) but also a strong commitment by the company of its desire to maintain such financial profile. In our view, the likelihood is very limited.”

### RELATED CRITERIA AND RESEARCH

#### Related Criteria:

- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology And Assumptions: Liquidity Descriptors for Global Corporate Issuers, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008
- Methodology: Industry Risk, Nov. 19, 2013

- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013

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Research Update:

## Outlook On Auckland International Airport Revised To Stable On Announcement Of NZ\$454 Million Capital Return

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# Outlook On Auckland International Airport Revised To Stable On Announcement Of NZ\$454 Million Capital Return

## Overview

- On Nov. 28, 2013, Auckland Airport announced its intention to undertake a NZ\$454 million capital return, expected to be completed by mid-April 2014.
- We expect this capital return to be almost entirely debt funded, and, as such, we forecast the key financial metrics to drop from our previous expectation.
- As a result, we are revising our rating outlook on Auckland Airport to stable from positive, and affirming the ratings at 'A-/A-2'.
- Auckland Airport's 'A-/A-2' ratings are underpinned by our view of the company's excellent business risk and intermediate financial risk profiles, and our expectation of the business's continued stability.

## Rating Action

On Dec. 3, 2013, Standard & Poor's Ratings Services revised its outlook on Auckland International Airport Ltd. (AIAL) to stable from positive, and affirmed its 'A-/A-2' ratings on the company.

## Rationale

The outlook revision follows AIAL's announcement that it intends to undertake a NZ\$454 million capital return, expected to be completed by mid-April 2014, which will be largely debt funded. The increase in debt will drive a relative weakening of the key financial metrics over the short term, in relation to our prior expectations, although this deterioration is not severe enough to result in the ratings being under downward pressure.

Prior to the announcement, we expected the key ratios of funds from operations (FFO) to debt and FFO interest coverage for Auckland Airport to remain around 18% and 4x, respectively, which are levels that we considered to be commensurate with a higher rating, despite our doubts about AIAL management's intention to maintain those levels. The decision to undertake the shareholder-friendly transaction clearly indicates, in our view, that the company is unwilling to materially improve its credit quality (and we therefore doubt it might do so in the future), but we continue to believe, as evidenced by the quantum of that capital return, that AIAL remains committed to maintaining a strong 'A-' rating.

We view AIAL's business risk profile as "excellent". This assessment is based

on our view of the company's dominant position in the New Zealand airport sector, capturing about 75% of the international passenger traffic and 90% of long-haul travelers. This is further supported by the fact that almost half of the country's population lives in AIAL's catchment area. Our assessment also incorporates our view of the transportation infrastructure industry's "low" risk and New Zealand's "low" country risk. These factors all support our expectation of stable and predictable cash flows and continued, albeit moderate, growth. The business risk profile is further supported by AIAL's excellent profitability that is higher and less volatile than other companies in the transportation infrastructure sector.

We assess AIAL's financial risk profile as "intermediate". This opinion is driven by our expectation that AIAL's key financial metrics will remain in the lower half of the range for this given assessment and our expectation that the company will be managed to maintain financial metrics at about those levels.

AIAL's relatively smaller scale and greater exposure to international passenger traffic compared to global airport peers with an excellent business risk profile means that we view AIAL's business risk profile as relatively weaker compared to peers. As a result, we assess the company's anchor score at 'a'.

In our view, the recently announced capital return indicates that the company's financial discipline will constrain the rating's upside potential, as we have doubt that the company would run the business metrics materially higher than those we are now expecting. We believe, though, that AIAL is strongly committed to its current rating, and that its financial policy framework would be supportive should operating conditions deteriorate.

Our base case assumes:

- Moderate domestic and international passenger growth averaging about 2%-to-3% over the next three years;
- EBITDA margins maintained in the high 70% range; and
- Capital expenditure of about NZ\$120 million-NZ\$130 million in the current year.

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

- FFO to debt remaining at around 14%-16% over the 2014-to-2016 period; and
- FFO cash interest cover ratio remaining above 3.5x over the same period.

### **Liquidity**

Our short-term rating on AIAL is 'A-2', which reflects the company's long-term corporate credit rating and adequate liquidity. We expect sources of liquidity (including forecast FFO, cash balances and undrawn bank facilities) to exceed estimated uses by 1.2x over the next 12 months, and liquidity sources remaining above estimates, even if EBITDA were to drop by at least 15%. In our view, AIAL is a well-regarded borrower in the New Zealand bank market and has demonstrated its ability to raise funds in other markets as well in the past.



Principal liquidity sources include:

- FFO marginally higher than in 2013;
- Cash and undrawn facilities, net of back-up lines supporting commercial paper, of about NZ\$180 million at June 30, 2013; and
- Our expectation that AIAL will immediately put in place short-term bank lines to provide funding certainty for the capital return and AIAL's intention to term those out once the capital return has been approved.

Principal liquidity uses per our base case include:

- Capital expenditure of about NZ\$130 million
- Capital return of NZ\$454 million and a final dividend of NZ\$80 million to NZ\$90 million, representing a marginal increase on last year's.

## **Outlook**

The stable outlook is based on our view that AIAL's financial metrics will remain at above 15% and 3.5x for FFO to debt and FFO cash interest coverage, respectively. This is despite the recent announcement that the company intends to implement a capital reduction of NZ\$454 million in April 2014. The outlook also reflects our view that AIAL will maintain its excellent business-risk profile.

### **Downside scenario**

AIAL's rating could be under pressure if its financial performance deteriorates to the point whereby we would expect FFO to debt to drop below 12% or FFO interest coverage below 2.5x on a sustained basis. This could occur in the following scenarios:

- AIAL increases its expected capital-expenditure program over the next two-to-three years, which would result in debt levels being higher than our expectations;
- AIAL undertakes acquisitions that would materially affect its financial metrics or business profile; or
- There were materially adverse regulatory developments that resulted in significant uncertainty as to AIAL's ability to earn an adequate return on its assets and future aeronautical investments.

### **Upside scenario**

We believe that the recent capital return provides a clear signal about the company's capital management and that therefore any future financial performance upside is likely to ultimately be returned to shareholders. As such, any upside in the rating would not only require significant improvement in financial metrics (such as FFO to debt consistently above 18%) but also a strong commitment by the company of its desire to maintain such financial profile. In our view, the likelihood is very limited.

## Related Criteria And Research

### Related Criteria

- Corporate Methodology, Nov. 19, 2013
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### Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Auckland International Airport Ltd.		
Corporate Credit Rating	A-/Stable/A-2	A-/Positive/A-2
Senior Unsecured	A-	
Commercial Paper	A-2	

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