

Bulletin:

Heathrow's Current And Forecast Results Are In Line With The Ratings

February 22, 2024

This report does not constitute a rating action.

LONDON (S&P Global Ratings) Feb. 22, 2024--S&P Global Ratings today said U.K.-based airport Heathrow Funding Ltd. (Heathrow: Class A wrapped debt: AA/Stable; Class A debt: BBB+/Stable; Class B debt: BBB-/Stable) posted 2023 results that support our ratings on the company's transactions. We expect 2024 performance to remain resilient and in line with our expectations of funds from operations (FFO) to senior debt of 7%-8% and FFO to debt of 5%-6% for class A and B, respectively, further bolstering the ratings.

We estimate Heathrow delivered S&P Global Ratings-adjusted FFO to senior debt of 7%-8% in 2023, and FFO to debt of 5%-6% (pending analytical adjustments once Heathrow releases its complete annual report). As anticipated, the airport's EBITDA in 2023 was £2.2 billion, in line with the high end of our forecast range. This was mostly fueled by a strong recovery of passenger that reached 79.2 million, specially from long-haul destinations, together with a charge cap of £31.57 per passenger. The EBITDA increase partially offsets the rise in reported net debt of 1.5% year-on-year (and about 20% from 2019 levels) to £14.8 billion--of which £12.6 billion consists of senior (class A) net debt and £2.2 billion in junior (class B) net debt. Although metrics should be in line with our expectations, we still think Heathrow has limited headroom under its financial risk profile should it underperform. We will continue monitoring its financial policy, notably dividend distributions to support debt repayment at holding company Heathrow Finance PLC (HF), in addition to the interest payments of about £150 million annually.

Passenger volumes at Heathrow reached 79.2 million in 2023, 28.5% higher than in 2022 and 97.9% of 2019 levels. This was also slightly above our previous expectation of 78.5 million for the year. Heathrow remains the busiest airport in Europe and has been outperforming its hub-rated peers--Charles de Gaulle airport in Paris ended 2023 with 67.4 million passengers, or 88.5% of 2019 levels; and Schiphol in Amsterdam reached 61.9 million, or 86.3%--confirming a resilient demand despite a more challenging economy with higher costs of living and more expensive air fares. Long-haul passengers, which represented 55% of total figures, have already surpassed pre-pandemic levels (101.9%). In particular, the New York route remained the most popular, with more than 3 million passengers, and 24 routes served more than a million passengers each throughout the year. Although the Asia-Pacific region fully reopened its borders only in first-quarter 2023, volumes have significantly rebounded. On the other hand, think short-haul passengers, mostly within the U.K. and Europe, are still below 2019 levels (at 94%), which

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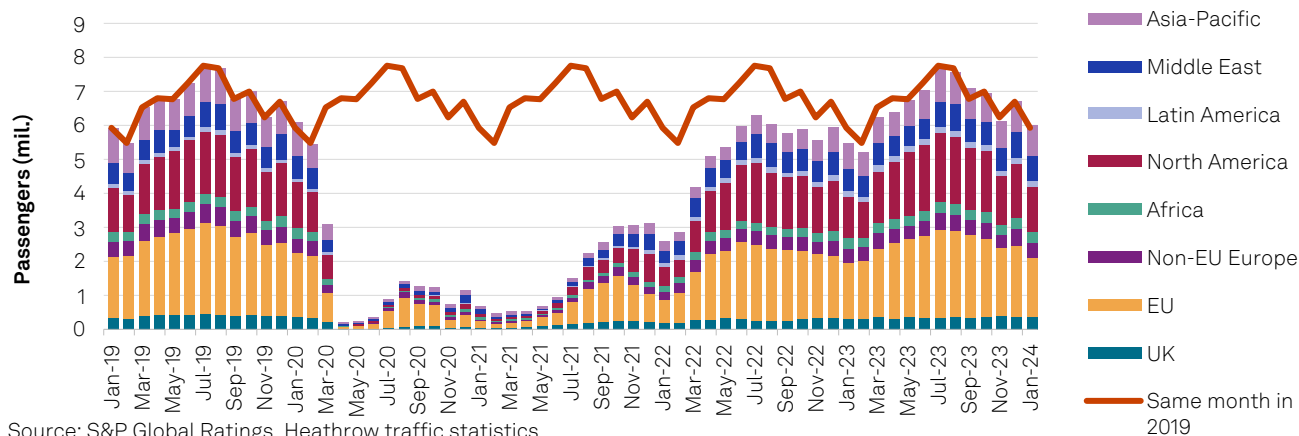
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structural changes related to the shift to remote working could partially explain. The passenger mix changed slightly, with leisure traffic increasing its contribution to 73% from 68% while business travel represents 27% of the passengers nowadays, versus 32% in 2019.

Heathrow passengers have already surpassed 2019 levels

2024 can be the airport's busiest year yet with about 81 million passengers



Source: S&P Global Ratings, Heathrow traffic statistics.

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We expect airport traffic at Heathrow airport to reach about 81.0 million passengers in 2024, which is broadly in line with the company's most recent guidance of achieving 81.4 million passengers during this year.

Heathrow's charge cap dropped by about 20% in January 2024--to £26.74 from £31.57 in 2023--as anticipated. This follows the final decisions from the regular Civil Aviation Authority (CAA), published in March 2023, and the Competition and Markets Authority's (CMA) determination in October. The new tariff will lower Heathrow's EBITDA to £1.8 billion-£1.9 billion and margins to about 55% in 2024 from £2.2 billion and 60.4% in 2023, respectively. Additionally, the incremental investments in maintenance, especially to upgrading security scanners at the airport and the baggage system at Terminal 2, could result in negative free cash flow and credit metrics with limited headroom, although still commensurate with the ratings.

We will continue monitoring the following key developments:

- Planned ownership change at Heathrow. On Nov. 28, 2023, Netherlands-based global construction company Ferrovial SE (BBB/Stable/A-2) signed an agreement to sell its approximately 25% stake in FGP Topco, the parent company of Heathrow Airport Holdings Ltd., for about £2.4 billion to France-based private equity firm Ardian, which intends to acquire about 15% of FGP Topco; and Saudi Arabia's Public Investment Fund (PIF), which intends to acquire about 10%. However, some shareholders have exercised their tag-along rights with these additional shares representing 35% of FGP Topco, making the whole transaction a 60% sale of FGP shares. The transaction continues to be subject to the tag-along condition, along with applicable regulatory requirements. Heathrow's class A and B debt are not subject to any change of control clause, so they cannot be accelerated due to changes in the shareholder structure. However, HF has financial covenants with a change of control clause affecting at least £1.1 billion of public bonds and owes £1.2 billion of private loans that are likely to include similar change of control clauses and could be triggered in case a group of shareholders representing more than 50% buy FGP Topco and act in concert, retaining control of the company. In that case, we believe management would seek alternative measures, such as waiver fee payments or a refinancing of HF's debt, before using Heathrow's liquidity given our understanding of its commitment to the rating. We think an extraordinary cash outflow from the ring-fenced structure, up to the covenant triggers,

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could deteriorate Heathrow's credit metrics below our FFO to senior debt of 7% and FFO to debt of 5%.

- Expansion plans and potential construction of the third runway. Heathrow should approach the cap of 480,000 air traffic movements per year in the next few years. Management, which changed last October with the appointment of Thomas Woldbye as CEO, is discussing alternatives to expanding the airport, including construction of a third runway. We think the targets to reduce carbon emissions from aircrafts could ultimately reduce the number of flights--although the current strategy of the U.K. government is to develop sustainable aviation fuel (SAF) facilities to replace jet fuel rather than investing in rail to replace short-haul flights such as other European countries like France, Germany, and Spain are working on--and the expropriation of areas surrounding the airport could pose challenges to Heathrow's expansion plans. In the current investment plan incorporated into Heathrow's charge cap for the H7 regulatory period (that will last until 2026), the airport's expansion is not considered. Discussions for the next regulatory period (H8, lasting from 2027-2031) should start this year, so we think this will be one of the topics that Heathrow and the airlines will bring to the discussion with the regulator. We will also monitor the expansion plans of other airports in London, such as Gatwick, which is planning to extend its northern runway.
- Discussions on the reinstatement of tax-free shopping for tourists. Since Brexit took effect Jan. 1, 2021, tourists visiting the U.K. no longer benefit of tax refunds on their purchases, although those to other European countries still do. The government is discussing bringing back this feature in its spring budget announcement. Resuming this program could boost Heathrow's commercial revenue, which ended 2023 at £8.82 per passenger, compared with £8.93 in 2019 in nominal terms.

Related Research

- Industry Credit Outlook 2024: Transportation Infrastructure, Jan. 9, 2024
- Bulletin: Structural Features Of Heathrow Funding's Debt Would Likely Protect Creditors After Ownership Change, Nov. 30, 2023
- Heathrow Funding's Proposed Guaranteed Class A Notes Assigned 'AA' Rating; Outlook Stable, Nov. 14, 2023
- Tear Sheet: Heathrow Funding Ltd., Oct. 27, 2023
- European Air Travel Defies Economic Pressures On Robust Demand, June 7, 2023
- Heathrow Funding Ltd., May 5, 2023

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