Fitch Rates BAA's Class B bond 'BBB'; Outlook Stable Ratings

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Fitch Ratings-Paris/London-09 September 2010: Fitch Ratings has assigned BAA Funding Ltd's (BAA) GBP400m Class B bond a 'BBB' rating. This bond is intended to prepay an existing bank facility at the operating company level. Fitch has also affirmed the 'A-' rating on BAA's Class A bonds. The Rating Outlook on all the bonds is Stable.

BAA also raised a GBP625m four-year 'Class B' bank junior debt facility and GBP375m under revolving credit facilities in August. The junior debt facility and revolving facilities, together with GBP100m proceeds from asset disposals, will be used to refinance the GBP1.57bn subordinated acquisition debt held by the holding company, BAA (SH).

"What initially appears to be a significant increase in leverage at the operating company is mitigated by the lower cost of debt achieved in the last 10 months," says Nicolas Painvin, Head of Fitch's Transportation Group in Paris. "Further, there are the benefits of inflation on the regulated asset base and the removal of near-term refinancing risk, as well as the GBP500m equity injection from shareholders that occurred earlier this year, of which only half had been expected at the last rating review."

Fitch has reviewed the updated financial forecast and its main assumptions, and took comfort that the main credit metrics, in particular the gearing (net debt to regulated asset base (net debt /RAB) and, more importantly, the debt coverage (through the Fitch-calculated post-maintenance interest cover ratio (PMICR), are in line with Fitch's expectations. The agency expects that the PMICR would not fall below 1.5x-1.6x for class A and 1.2x-1.3x for class B. PMICR is a metric that Fitch uses in rating the UK regulated utilities. It is a cash-based coverage ratio, adjusted for a theoretical depreciation required by the regulator to maintain a stable asset base.

BAA is the largest airport owner globally. Passenger traffic at BAA's Heathrow and Stansted airports remain a key performance driver. However, the updated plan retains the lower traffic forecasts assumed in the autumn of 2009. This has reduced the risk of underperformance, and the underlying performance (ie after adjustments of one-off effects such as the volcanic ash cloud) has been higher than planned. There is still a risk that market fundamentals deteriorate again or that the economic recovery will take longer than BAA expects. Nevertheless, Fitch views this prospect as remote, given the return to growth in traffic in recent months and the resilience of Heathrow airport throughout the global financial crisis.

Although BAA has covered its material refinancing needs until March 2012, the ability to refinance further the existing bank facilities beyond this date remains an important rating factor.
A new regulatory re-set will determine the price cap on aeronautical tariffs from April 2013 to March 2018, and will rebase the revenue flow on the actual level of passengers with an appropriate tariff increase. Fitch continues to believe that there is always an embedded risk in regulatory resets, as the cost of debt that the regulator (CAA) will allow for in the tariff is a function of the assumptions retained by the regulator in terms of gearing and the proportion of index-linked debt.

Fitch has analysed sensitivities run by BAA on parameters including inflation and operating expenditure.

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