MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Heathrow Finance's ratings; outlook remains negative

24 Jun 2020

London, 24 June 2020 -- Moody's Investors Service (Moody's) has today affirmed Heathrow Finance plc's (HF) Ba1 Corporate Family Rating (CFR), its Ba2-PD Probability of Default Rating (PDR) and the Ba3 senior secured debt rating. The outlook on the ratings remains negative. HF, through its shares in Heathrow (SP) Limited (HSP), owns London Heathrow Airport (LHR).

RATINGS RATIONALE

The rating affirmation reflects that, notwithstanding the significant detrimental impact on cash flows associated with the decline in traffic due to the coronavirus outbreak, HF, through its ownership of LHR, remains a key infrastructure provider, with potential for a strong recovery once the outbreak and its effects have been contained. In this context, the affirmation of HF's ratings recognises the company's good liquidity profile and Moody's expectation that, notwithstanding the breadth and severity of the coronavirus outbreak and the consequent shock on passenger numbers at LHR, the company will also implement measures aimed at supporting and restoring its financial profile, with key financial metrics anticipated to return to levels more commensurate with current ratings over the next two to three years. The negative outlook, however, reflects the downside risks to HF's credit profile linked to the consequences of the coronavirus outbreak and the significant uncertainties around traffic recovery prospects.

The rapid spread of the coronavirus outbreak, severe global economic shock, low oil prices, and asset price volatility are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The airport sector has been one of the most significantly affected by the shock, given its sensitivity to consumer demand and sentiment. HF remains exposed to the reduction in passenger volumes as a result of the coronavirus epidemic, which has left it vulnerable to shifts in market sentiment in these unprecedented operating conditions, while HF is also exposed to the outbreak continuing to spread. Moody's regards the coronavirus outbreak as a social risk under its ESG framework, given the substantial implications for public health and safety.

Moody's expects the lifting of travel restrictions linked to the coronavirus outbreak to result in the resumption of flight activity over Q3 and Q4 of 2020, but traffic will remain severely depressed, with domestic travel recovering earlier and a slower return for international and long haul flights. In this context, Moody's currently assumes that the decline in passenger traffic at LHR will be in the range of 60%-65% in the financial year ending December 2020, while passenger levels are unlikely to reach 2019 levels until 2023 at the earliest. There are, however, risks of more challenging downside scenarios, while recovery trends remain highly uncertain because (1) LHR exhibits a material exposure to long haul traffic (more than half of total), as well as business and premium leisure travel, (2) travel restrictions in some form may continue for some time even if the spread of the virus seems contained in some areas; (3) the deteriorating global economic outlook would likely slow the recovery in traffic and consumer spending, even if travel restrictions are eased; and (4) the coronavirus outbreak is also weakening the credit profile of airlines, which have been drastically cutting capacity.

More generally, HF's Ba1 CFR continues to reflect (1) its ownership of LHR, which is one of the world's most important hub airports and the largest European airport, (2) its long established framework of economic regulation, (3) the historically resilient traffic characteristics of LHR, (4) the capacity constraints the airport faced prior to the traffic declines linked to the coronavirus outbreak, (5) the current period of lower capital expenditure levels, (6) an expectation that the HF group will maintain high leverage, and (7) the features of the HSP secured debt financing structure, which puts certain constraints around management activity, together with the protective features of the HF debt, which effectively limit HF's activities to its investment in HSP. HF's Ba3 senior secured rating reflects the structural subordination of the HF debt in the HF group structure versus the debt at HSP.

LIQUIDITY AND DEBT COVENANTS

The HF group as a whole exhibits a good liquidity position, allowing for flexibility to cover its expenditure in the context of the significant deterioration in cash flows associated with the experienced contraction in traffic levels. Moody's understands that, as of the end of June 2020, the HF group expects to have approximately GBP2.6 billion of cash on balance sheet (of which GBP442 million at the level of HF). Within the group, HSP and HF also maintain liquidity arising from delayed drawdowns under previously issued debt (GBP80 million and GBP50 million, respectively). More specifically, HF's significant liquidity availability would enable the company to support its debt service requirements (approximately GBP100 million per annum) even in absence of dividends upstreamed from HSP, which would normally represent the company's exclusive source of cash flow. HF's next debt maturity is in 2024. The HF group is also implementing initiatives aimed at reducing, where possible, its cost base and investment spend, with the objective of supporting its liquidity and financial profile in the short term. The HF group expects to have sufficient liquidity to meet all its obligations until at least June 2021 under the extreme stress test scenario of no revenue, or well into 2022 under its own base case traffic forecast, which envisage a traffic contraction of 64% in 2020, with passenger levels in 2021 expected to remain around 22% below 2019.

Given the magnitude of the reduction in earnings associated with traffic declines, HF is expected to trigger default financial covenants included in its debt documentation, namely group Net Debt/RAB of 92.5% (both at the December 2020 and December 2021 calculation date) and Interest Cover Ratio of 1.0x (at the December 2020 calculation date). In addition, the group's debt documentation includes covenants at the level of HSP. Given the contraction in cash flows, HSP's Interest Cover Ratio is expected to trigger lock-up levels at the December 2020 calculation date, which means that the company will not be permitted to upstream cash to HF. In the context of the trigger of default financial covenants, HF has formally launched a consent solicitation process to obtain a waiver for the Interest Cover Ratio covenant and to increase the HF Net Debt/RAB threshold to 95% in 2020 and 93.5% in 2021. In addition, as part of the process, HF is proposing a prohibition on dividend payments for the duration of the waiver period or, if later, until Net Debt/RAB reaches the level of 87.5% or below. Moody's expects the solicitation process to conclude successfully, but the negative rating outlook also reflects the residual risk that creditors' approval may not be forthcoming.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

In light of the current negative outlook, upward rating pressure on HF's ratings is unlikely in the near future. The outlook could be stabilised if, following the lifting of border and travel restrictions and a return to normal traffic performance, the company's financial profile and key credit metrics sustainably return to levels commensurate with the current rating, while continuing to maintain a good liquidity profile, coupled with the successful finalisation of the waiver process aimed at resolving default covenant breaches.

Downward pressure on HF's ratings could develop if (1) it were to exhibit a financial profile permanently below the levels considered commensurate with the current rating, leading to a reduced headroom under its Net Debt/RAB covenant of 92.5% or an Adjusted Interest Cover Ratio consistently lower than 1.0x; (2) the group's liquidity profile deteriorates; (3) there was an increased risk of extended covenant breaches; or (4) it appeared likely that the coronavirus outbreak had a more severe or sustained detrimental impact on traffic levels.

The principal methodology used in these ratings was Privately Managed Airports and Related Issuers published in September 2017 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1092224. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The only asset of HF is its shares in HSP, a holding company which in turns owns the company that owns LHR, Europe's busiest airport in terms of total passengers. HF is indirectly owned by Heathrow Airport Holdings Limited (HAH). HAH is ultimately owned 25% by Ferrovial S.A. (a Spanish infrastructure & construction company), 20% by Qatar Holding LLC (a sovereign wealth fund), 12.62% by Caisse de depot et placement du Quebec (a pension fund), 11.2% by the Government of Singapore Investment Corporation (a sovereign wealth fund), 11.18% by Alinda Capital Partners (an infrastructure fund), 10% by China Investment Corporation (a sovereign wealth fund) and 10% by the University Superannuation Scheme (a pension scheme).

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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