

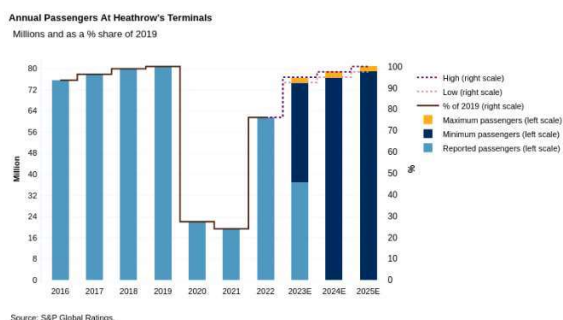
Tear Sheet:

Heathrow Funding Ltd.

July 27, 2023

Passenger numbers are rebounding. In the first half of 2023, 37.1 million passengers used Heathrow airport--equivalent to 95.7% of 2019 levels and ahead of our expectations--mostly for leisurely travel. Despite macroeconomic uncertainties, we expect passenger volumes to continue growing in 2023, mainly on the back of a solid summer holiday season in Europe and the return of Asian traffic after all travel restrictions were lifted in the first quarter of this year. Based on the strong air traffic performance, we have slightly increased our passenger forecast for this year to 76.5 million, from the 75.0 million we had forecast previously. This revised assumption does materially affect our guidance for Heathrow's financial metrics in 2023. For 2024 and 2025, our assumptions remain unchanged.

Chart 1



The 2023 half-year financial results point to a solid financial recovery for the year. The company's revenues and EBITDA increased by 36.1% and 43.8% to £1.7 billion and £1.1 billion, respectively. This should enable the company to meet our forecast of £3.4 billion-£4.0 billion revenues and £1.9 billion-£2.1 billion EBITDA for the year. In addition to the recovery in passenger volumes, we also factor in higher aeronautical charges, so its credit metrics for the year should be better than the rating thresholds. In comparison with the same period in 2022, average retail revenue per passenger decreased by 8.3% to £8.68, mostly reflecting the removal of duty-free shopping. We expect Heathrow will post FFO to senior debt of 8.5%-9.5% and FFO to junior debt of 6.5%-7.5% in 2023.

Heathrow will charge less from 2024 after the Competition and Markets Authority (CMA) reviews the appeal requests. The CMA will make a decision about the appealed building blocks of the H7 regulatory framework by Oct. 17, 2023. We are assuming in our base-case scenario that Heathrow's tariffs will drop by 20% in 2024, in line with the Civil Aviation Authority's final decision as of March 2023. Even if the CMA rules that Heathrow's charge caps should lower further--which we view as a worst-case scenario--the company would be able to sustain credit

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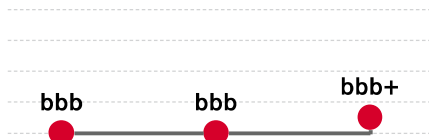
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metrics commensurate with the current ratings because it would be able to take mitigating measures, albeit with a limited cushion for underperformance.

Ratings Score Snapshot

Business risk: **Excellent**



BBB+/Stable

Financial risk: **Aggressive**



Anchor Modifiers Structural features

Class A Issue Rating

Business risk: **Excellent**



BBB-/Stable

Financial risk: **Highly Leveraged**



Anchor Modifiers Structural features

Class B Issue Rating

Recent Research

Industry Top Trends Update Europe: Transportation Infrastructure, July 18, 2023

European Air Travel Defies Economic Pressures On Robust Demand, June 7, 2023

Heathrow Funding Ltd, May 5, 2023

Bulletin: Appeals Regarding CAA's Airport Fees Ruling Expected To Be Broadly Credit Neutral For Heathrow, April 21, 2023

Credit FAQ: Lower Tariffs Will Leave A Thin Cushion Around Heathrow's Debt Metrics, April 6, 2023

Research Update: Heathrow Funding Class A 'BBB+' And Class B 'BBB-' Ratings Affirmed On CAA Decision; Off CreditWatch; Outlook Stable, March 22, 2023

Company Description

Heathrow Funding Ltd.

Heathrow Funding Ltd. (HFL) is a wholly owned subsidiary of Heathrow (SP) Ltd., a debt-issuing vehicle in the ring-fenced financing group. This group also includes the operating company Heathrow Airport Ltd. (HAL) that owns and operates Heathrow airport. HAL is the borrower of the debt issued through HFL.

Above the financing group, there are several holding companies until reaching the shareholders. Ferrovial S.A. (BBB/Stable/A-2) is currently the largest shareholder (25%), followed by Qatar Holding LLC (20%). The remaining 55% stake is spread across other institutional investors.

In the first six months of 2023, Heathrow reported revenues of £1.7 billion and EBITDA of £1.1 million, while its cash position was £1.2 billion--very close to its principal debt maturities of £1.0 billion in the following 12 months.

Outlook

The stable outlook reflects our view that, despite lower tariffs and higher investments, Heathrow will be able to deliver metrics in line with the current ratings--notably FFO to senior debt of at least 7% and FFO to junior debt of at least 5% until the end of H7. This is based on more certainty on the tariff for H7, passenger recovery, and Heathrow's financial discipline.

Downside scenario

We could take a negative rating action on the Class A and Class B debt if Heathrow is not able to achieve and sustain FFO to senior debt at 7.0% or FFO to junior debt at 5.0% with no immediate likelihood of recovery. This could happen, for example:

- Following the appeal, if the CMA decides Heathrow's tariffs should be lowered further, and if Heathrow takes no further mitigating actions.
- If there are significant cash outflows from the ring-fenced structure, in addition to the interest payments related to the debentures with Heathrow Finance PLC, such as partial repayment of the debentures with Heathrow Finance, or distributing dividends to shareholders, resulting in a less supportive financial policy.
- If inflation fails to return to a long-term average of 2.0% and Heathrow is not able to mitigate the negative effect of this.

Upside scenario

In our view, ratings upside is somewhat limited until the end of H7. However, we could raise the ratings if Heathrow achieved and maintained FFO to senior debt consistently above 8.0% and FFO to junior debt above 6.0% from 2024. This could happen:

- As a result of the appeal, if the CMA decides Heathrow's tariffs should be higher than CAA's final decisions.
- If Heathrow can implement its strategy to increase commercial revenues and reduce the airport's operating expenses to be in line with or more efficient than the CAA anticipated in its final decisions.

Key Metrics

Period ending	Dec-31-2019	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025
(Mil. GBP)	2019a	2022a	2023e	2024f	2025f
Passengers (% of 2019 levels)	100	76.2	92.5-95	95-97.5	97.5-100
Passengers (million)	80.9	61.6	74.5-76.5	76.5-79.0	79.0-81.0
Charge cap (£ per passenger)	23.18	30.19	31.57	25.50-26.00	26.00-26.50
Revenue	3,070	2,913	3,400-4,000	2,900-3,600	3,100-3,800
EBITDA	1,924	1,684	1,900-2,100	1,600-1,800	1,700-1,900
Capital expenditure (capex)	856	442	650-700	850-900	1,200-1,300
Outflows from the ring-fenced	159	1,110	150-200	150-200	150-200
Adjusted ratios					
EBITDA margin (%)	62.7	57.8	55-60	50-55	50-55
FFO/Senior debt (%)	10.0	6.5	8.5-9.5	7.0-8.0	7.0-8.0
FFO/debt (%)	9.0	4.5	6.5-7.5	5.0-6.0	5.0-6.0

Financial Summary

Heathrow Funding Ltd.--Financial Summary

Period ending	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022
Reporting period	2017a	2018a	2019a	2020a	2021a	2022a
Display currency (mil.)	GBP	GBP	GBP	GBP	GBP	GBP
Revenues	2,884	2,970	3,070	1,175	1,214	2,913
EBITDA	1,812	1,886	1,924	124	384	1,684
Funds from operations (FFO)	960	1,053	1,169	(411)	(120)	677
Interest expense	856	801	620	608	694	888
Cash interest paid	799	763	657	602	503	1,006
Operating cash flow (OCF)	1,126	1,156	1,271	(654)	354	1,507
Capital expenditure	686	789	856	521	252	442
Free operating cash flow (FOCF)	440	367	415	(1,175)	102	1,065
Discretionary cash flow (DCF)	(179)	245	256	(495)	268	(45)
Cash and short-term investments	525	711	1,540	3,516	2,626	1,833
Gross available cash	525	711	1,540	3,516	2,626	1,833
Debt	12,723	12,651	13,033	14,036	13,744	15,043
Common equity	(2,635)	(2,636)	(2,774)	(4,757)	(6,041)	(6,200)
Adjusted ratios						
EBITDA margin (%)	62.8	63.5	62.7	10.6	31.6	57.8
Return on capital (%)	10.9	11.2	11.5	(6.9)	(4.8)	11.4
EBITDA interest coverage (x)	2.1	2.4	3.1	0.2	0.6	1.9
FFO cash interest coverage (x)	2.2	2.4	2.8	0.3	0.8	1.7
Debt/EBITDA (x)	7.0	6.7	6.8	113.2	35.8	8.9
FFO/debt (%)	7.5	8.3	9.0	(2.9)	(0.9)	4.5
OCF/debt (%)	8.9	9.1	9.8	(4.7)	2.6	10.0
FOCF/debt (%)	3.5	2.9	3.2	(8.4)	0.7	7.1
DCF/debt (%)	(1.4)	1.9	2.0	(3.5)	1.9	(0.3)

Peer Comparison

Heathrow Funding Ltd.--Peer Comparisons

	Heathrow Funding Ltd.	Aeroports de Paris	Royal Schiphol Group N.V.	Flughafen Zurich AG
Foreign currency issuer credit rating	--	A/Negative/--	A-/Stable/A-2	A+/Stable/--
Local currency issuer credit rating	--	A/Negative/--	A-/Stable/A-2	A+/Stable/--
Period	Annual	Annual	Annual	Annual
Period ending	2022-12-31	2022-12-31	2022-12-31	2022-12-31
Mil.	GBP	GBP	GBP	GBP
Revenue	2,913	4,158	1,322	893
EBITDA	1,684	1,587	331	499
Funds from operations (FFO)	677	1,315	241	479
Interest	888	235	68	20
Cash interest paid	1,006	245	78	15
Operating cash flow (OCF)	1,507	1,173	307	427
Capital expenditure	442	600	396	211
Free operating cash flow (FOCF)	1,065	572	(89)	215
Discretionary cash flow (DCF)	(45)	532	(462)	214
Cash and short-term investments	1,833	2,334	1,535	594
Gross available cash	1,833	2,334	1,535	579
Debt	15,043	8,179	3,366	1,168
Equity	(6,200)	4,306	3,110	2,405
EBITDA margin (%)	57.8	38.2	25.0	55.9
Return on capital (%)	11.4	7.5	1.1	6.6
EBITDA interest coverage (x)	1.9	6.8	4.8	24.7
FFO cash interest coverage (x)	1.7	6.4	4.1	34.0
Debt/EBITDA (x)	8.9	5.2	10.2	2.3
FFO/debt (%)	4.5	16.1	7.2	41.0
OCF/debt (%)	10.0	14.3	9.1	36.5
FOCF/debt (%)	7.1	7.0	(2.6)	18.4
DCF/debt (%)	(0.3)	6.5	(13.7)	18.4

Environmental, Social, And Governance

ESG Credit Indicators

E-1	E-2	E-3	E-4	E-5	S-1	S-2	S-3	S-4	S-5	G-1	G-2	G-3	G-4	G-5
- N/A					- Health and safety					- N/A				

N/A—Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumeric 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Social factors are a moderately negative consideration in our credit analysis. Passenger volumes continue to recovery to pre-pandemic levels as authorities lift COVID-19-related travel restrictions. In June 2023, passenger volumes reached 95.7% of 2019 levels, thanks to a rebound in both short- and long-haul flights. Furthermore, the reopening of China's borders has been contributing to an increase in long-haul passengers at Heathrow. Conversely, the rising cost of living, due to macroeconomic headwinds, could derail recovery.

Rating Component Scores

	Senior Secured Debt (Class A)	Subordinated Debt (Class B)
Issue rating	BBB+/Stable	BBB-/Stable
Business risk	Excellent	Excellent
Country risk	Low	Low
Industry risk	Low	Low
Competitive position	Excellent	Excellent
Financial risk	Aggressive	Highly leveraged
Cash flow/leverage	Aggressive	Highly leveraged
Anchor	bbb	bbb-
Diversification/portfolio effect	Neutral (no impact)	Neutral (no impact)
Capital structure	Neutral (no impact)	Neutral (no impact)
Financial policy	Neutral (no impact)	Neutral (no impact)
Liquidity	Strong (no impact)	Strong (no impact)
Management and governance	Satisfactory (no impact)	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)	Neutral (no impact)
Stand-alone credit profile	bbb	bbb-
Structural enhanced debt	+1 notch	None

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

Heathrow Funding Ltd.

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Utilities: Rating Structurally Enhanced Debt Issued By Regulated Utilities And Transportation Infrastructure Businesses, Feb. 24, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

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