S&P Global Ratings

RatingsDirect®

Heathrow Funding Ltd.

May 5, 2023

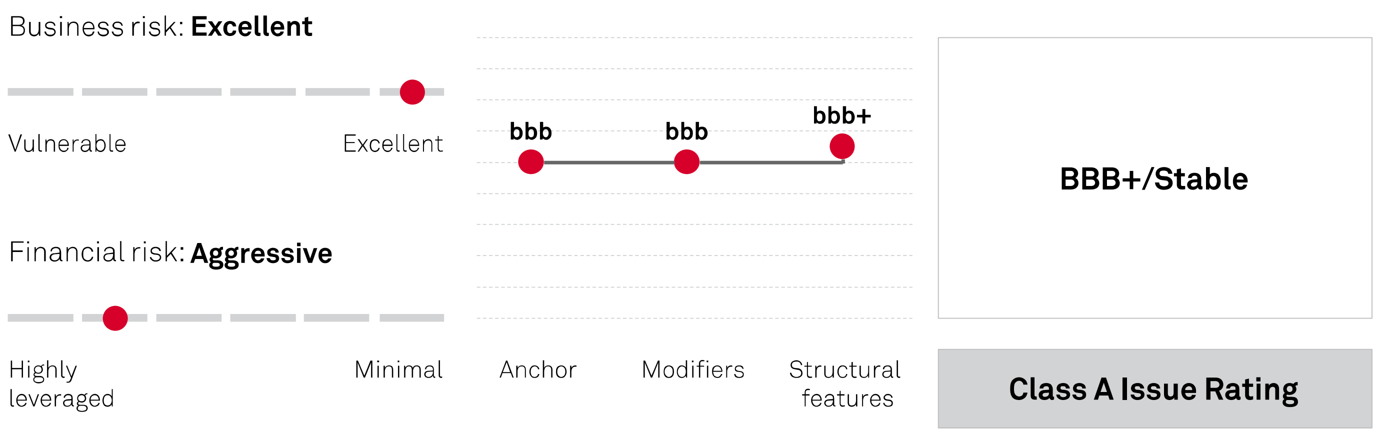
Ratings Score Snapshot

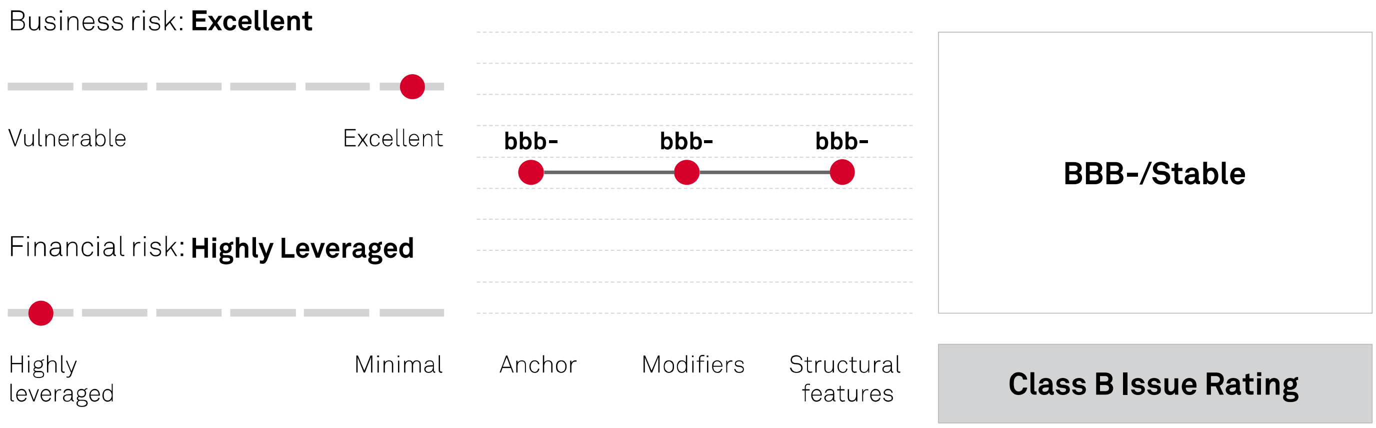
PRIMARY CONTACT

Vinicius Ferreira
London
44-20-7176-0526
vinicius.ferreira
@spglobal.com

SECONDARY CONTACT

Juliana C Gallo
London
44-20-7176-3612
juliana.gallo
@spglobal.com





Credit Highlights

Overview

Key strengths	Key risks
Excellent competitive position as the largest airport in Europe, and the only hub airport in the U.K., with a near monopoly on long-haul flights.	High indebtedness with limited headroom for underperformance, with expected funds from operations (FFO) to debt of 7%-8% for Class A and 5%-6% for Class B.
Independent regulatory framework that allows operating, capital, and financing cost recovery.	Negative free operating cash flow (FOCF) from fiscal 2024, due to significant capital expenditure (capex) of £4 billion in the remainder of H7 regulatory period.
Resilient traffic growth as pandemic-related impacts diminish, including favorable passenger mix, with 53% long-haul traffic in 2022	Credit metrics, notably FFO to debt, exposed to inflationary pressures due to substantial share of inflation linked debt.
Structural enhancements that reduce the default risk of notes issued by Heathrow Funding Ltd. (HFL) by allowing noteholders to take control of the business ahead of an insolvency of Heathrow (SP) Ltd.	

We assume that the Civil Aviation Authority (CAA) ruling to lower the charge cap for Heathrow will translate into lower profitability in the latter part of the H7 regulatory period (2022-2026). The CAA defined a charge cap of £21.03 per passenger (as of 2020 prices) from 2024, annually adjusted by the consumer price index (CPI). This results in a fall of almost 20% of the current £31.57 tariffs (£26.06 as of 2020 values). We expect the reduction in the pre-tax weighted average cost of capital (WACC) to 4.04% from 5.35% will hinder Heathrow's profitability during H7. The lower WACC incorporates that the airport will be subject to more efficient operating expense targets, which we think the airport may achieve from 2024. In the short term, we continue to believe that the airport will face increasing staff costs related to new hires as air travel demand accelerates. We also consider that the airport would choose to focus on increasing employee productivity as a supporting measure.

Regulatory Weighted-Average Cost of Capital (WACC) for Heathrow

	Q6 (2014-2021)	H7 (2022-2026)
Gearing	60%	60%
Total market return	6.25%	5.85%

Risk-free rate	0.50%	0.59%
Equity risk premium	5.75%	5.26%
Asset beta	0.50	0.53
Debt beta	0.10	0.075
Equity beta	1.10	1.21
Post-tax cost of equity	6.84%	6.96%
Cost of debt	3.20%	0.67%
Pre-tax WACC	5.35%	4.04%
Post-tax WACC	4.66%	3.18%

Source: CAA. Made by S&P Global Ratings.

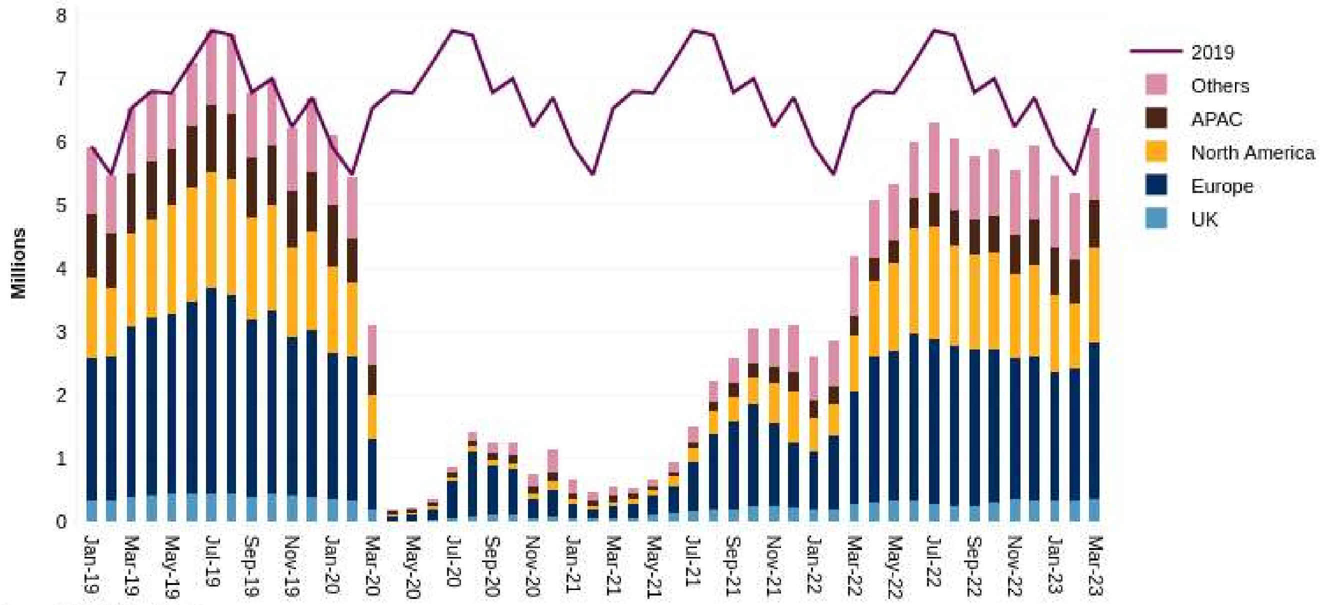
The recent appeals to the Competition and Markets Authority (CMA) on CAA's final decisions could change the tariffs from 2024 on. Under the most likely scenarios currently envisioned, we expect that Heathrow will be able to sustain credit metrics commensurate with the current rating level. Even if the worst scenarios were to materialize, we expect the company to take measures to maintain the current ratings, given its management commitment with the ratings.

Despite upcoming challenges in H7, including tougher regulations and potentially less flexibility for nonessential spending such as dividends, we think Heathrow will maintain good access to global capital markets. This suggests Heathrow could Issue debt to support its operations if needed, although at higher costs in the short term. Its regulation retains a long and stable record of an independent framework that allows operating, capital, and financing cost recovery, alongside strong ring-fencing conditions. Heathrow continues to operate as a single till airport, which is the hallmark of Its competitiveness. We continue to assess Heathrow as one of the most efficient airports in Europe. We believe savings obtained during the pandemic should allow it to sustain EBITDA margins of 50%-55% from 2024, although below its pre-pandemic margins of above 60%. That said, Heathrow continues to be one of the most profitable airports in Europe, and it is well positioned to remain a strategic hub and the busiest airport in the continent.

Heathrow's consistent passenger recovery at its terminals will partially offset the effect of lower charges. After travel restrictions were lifted in 2022, pent-up demand boosted traveler volumes in the airport to 61.6 million passengers--equal to 76.2% of 2019 levels. During the first three months of 2023, the number of passengers at Heathrow reached about 94.3% of 2019 levels, mostly for leisurely travel. We expect passenger volumes will continue rising in 2023, mainly on the back of no additional global travel restrictions at this time.

Monthly Passengers At Heathrow's Terminals

Comparison versus 2019

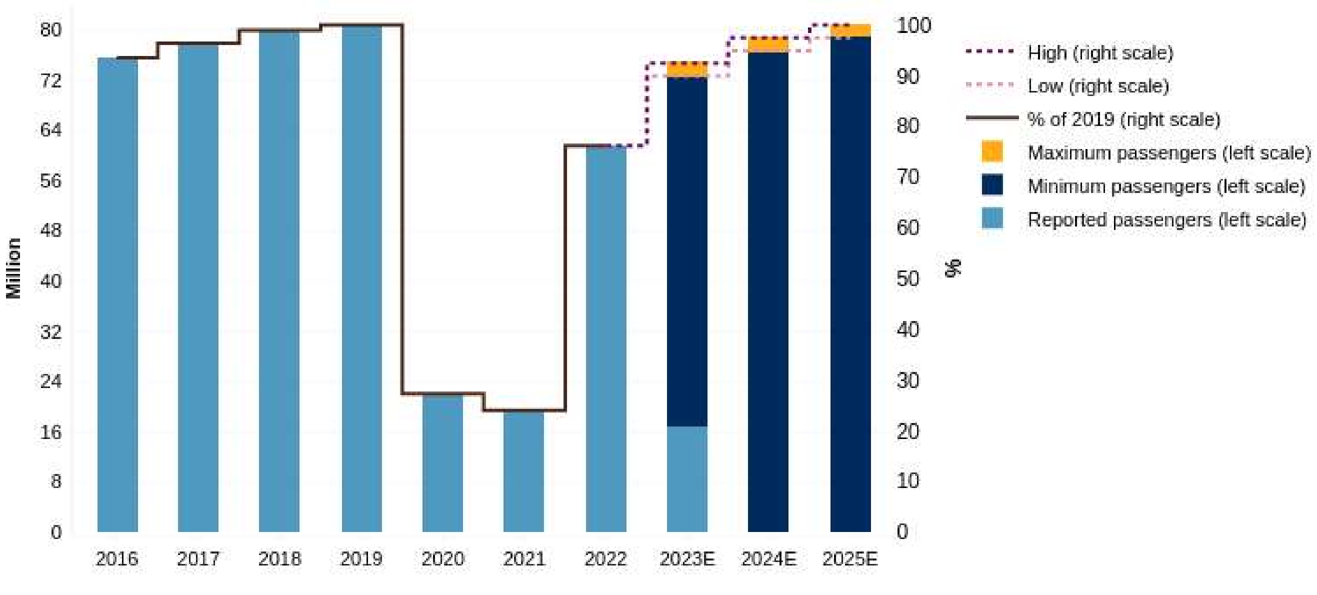


Source: S&P Global Ratings.

However, currently high inflation and interest rates, as well as more expensive ticket prices, may negatively affect consumers' discretionary spending, such as on travel. Although we forecast higher passenger volumes than previously, we think these economic headwinds could impede a strong passenger recovery at Heathrow. We forecast up to 75 million passengers in 2023 (92.5% of 2019 levels), no more than 80 million in 2024, and up to 81 million by 2025.

Annual Passengers At Heathrow's Terminals

Millions and as a % share of 2019



Source: S&P Global Ratings.

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 occur, 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 we expect Heathrow could achieve and maintain FFO to senior debt consistently above 8.0% and FFO to junior debt above 6.0% from 2024. This could occur if:

- 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 operate in line with or more efficiently than the CAA anticipated in its final decisions.

Our Base-Case Scenario

Assumptions

Our main assumptions for 2023-2025 are:

– Passenger traffic recovery will reach 90.0%-92.5% of 2019 levels in 2023, 95.0%-97.5% in 2024, and 97.5%-100.0% in 2025.
– The charge cap in 2023 will remain at £31.57 per passenger. Thereafter, we incorporate the CAA's tariff of £21.03 as of 2020 values. The values will be adjusted to their nominal values by our CPI assumptions of 7.0% in 2023, 0.9% in 2024, and 1.6% in 2025.
– No material growth on the retail revenue per passenger in the next years, considering the current macroeconomic environment and business travel still lagging behind leisure.
– Car-parking revenue growth at CPI growth rates.
– Heathrow's personnel-related expenses to grow above inflation during 2023, as the airport is still hiring new staff to face demand recovery. From 2024, we believe Heathrow's focus will be on efficiency gains to keep its profitability amid lower tariffs.
– Total investments, mostly focused on maintenance, ranging £650 million-£700 million in 2023, £850 million-£900 million in 2024, and £1.2 billion-£1.3 billion in 2025.
– Interest payments on the debentures from Heathrow Finance PLC between £150 million and £200 million annually as a cash outflow from the ring-fenced structure.

Key metrics

Heathrow Funding Ltd.--Key Metrics*

Mil. £	2019a	2022a	2023e	2024f	2025f
Passengers (% of 2019 levels)	100	76.2	90-92.5	95-97.5	97.5-100
Passengers (million)	80.9	61.6	72.5-75.0	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	3,200-3,800	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
EBITDA margin (%)	62.7	57.8	55-60	50-55	50-55
Capital expenditure	856	442	650-700	850-900	1,200-1,300
Outflows from the ring-fenced	159	1,110	150-200	150-200	150-200
FFO to senior debt (%)	10.0	6.5	8.5-9.5	7.0-8.0	7.0-8.0
FFO to debt (%)	9.0	4.5	6.5-7.5	5.0-6.0	5.0-6.0

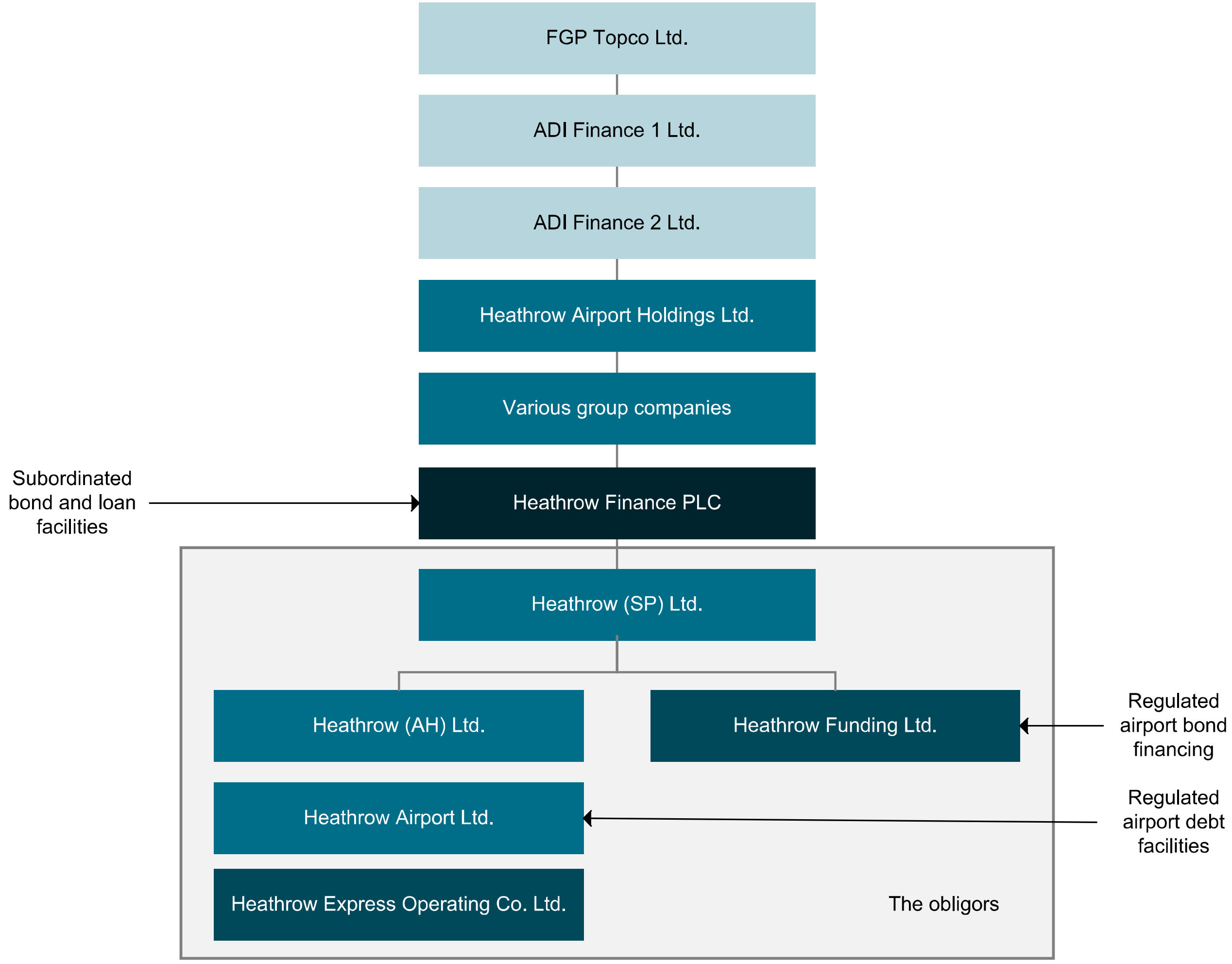
*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Company Description

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.

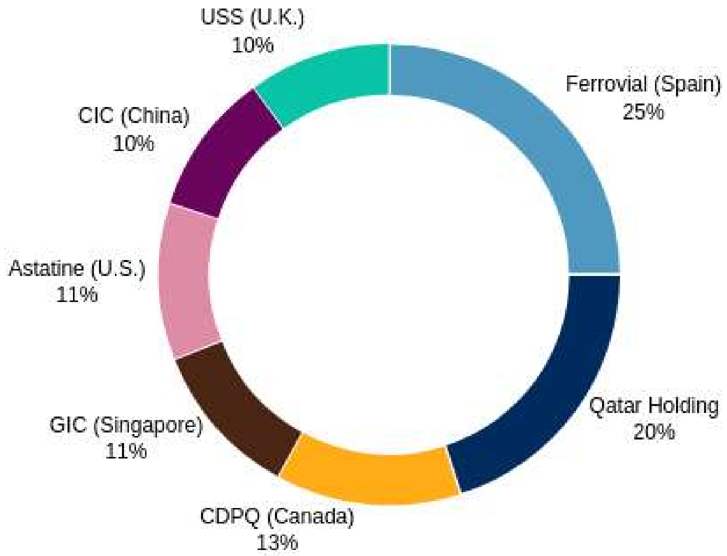
Above the financing group, there are several holding companies until reaching the shareholders. Ferrovial S.A. (BBB/Stable/A-2) is currently the largest shareholder (25%), followed by Qatar Holding LLC (20%). The remaining 55% stake is spread across other institutional investors.

Heathrow Funding Ltd. – Transaction Structure



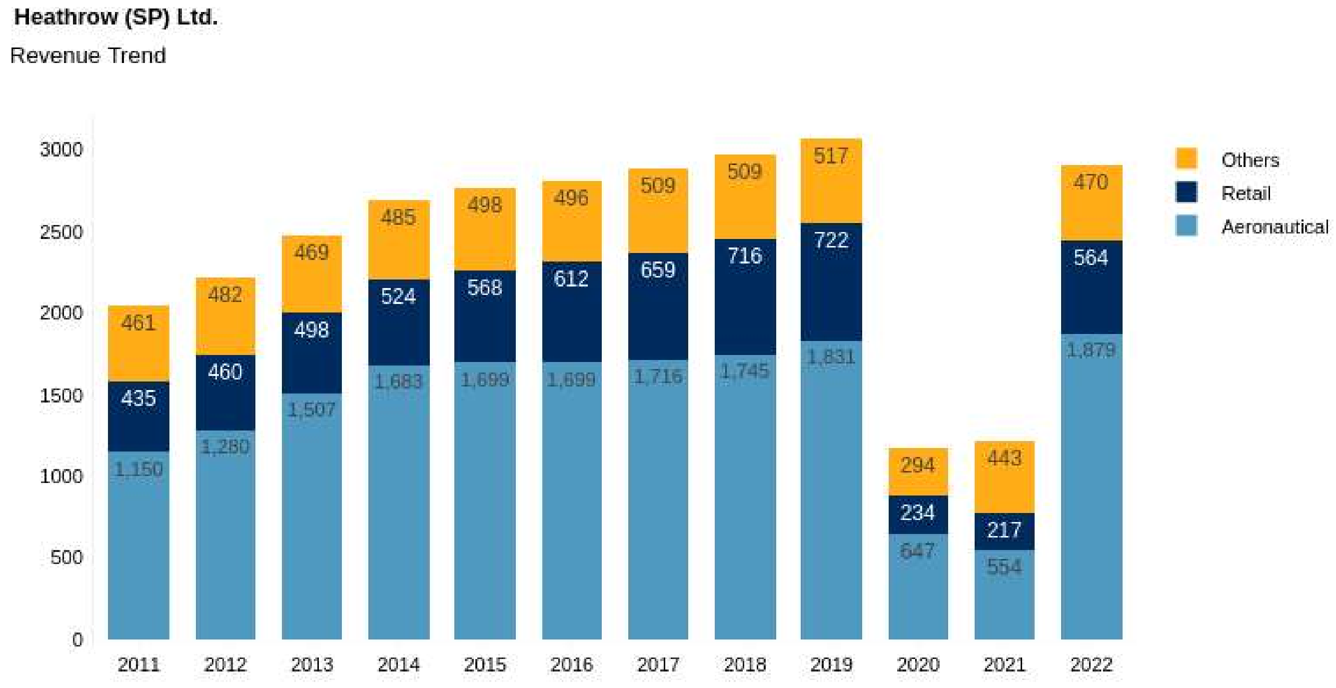
Source:Heathrow Funding Ltd.

Heathrow Airport Holdings Ltd. Ownership Structure



Source: S&P Global Ratings.

For fiscal 2022, the group's total revenues were £2.9 billion, from £1.2 billion in 2021 and S&P Global Ratings-adjusted EBITDA amounted £1.7 billion, from £384 million in 2021. The revenue base mainly comprises aeronautical revenue (about 65%), charged to airlines primarily for passenger facilities, take-off and landing, and aircraft parking. Under a single-till regulatory mechanism, revenues are subsidized by non-aeronautical income generated from retail, car parking, property rental, and Heathrow Express rail service. We are not expecting significant changes to the current revenue base.



Source: S&P Global Ratings.

Peer Comparison

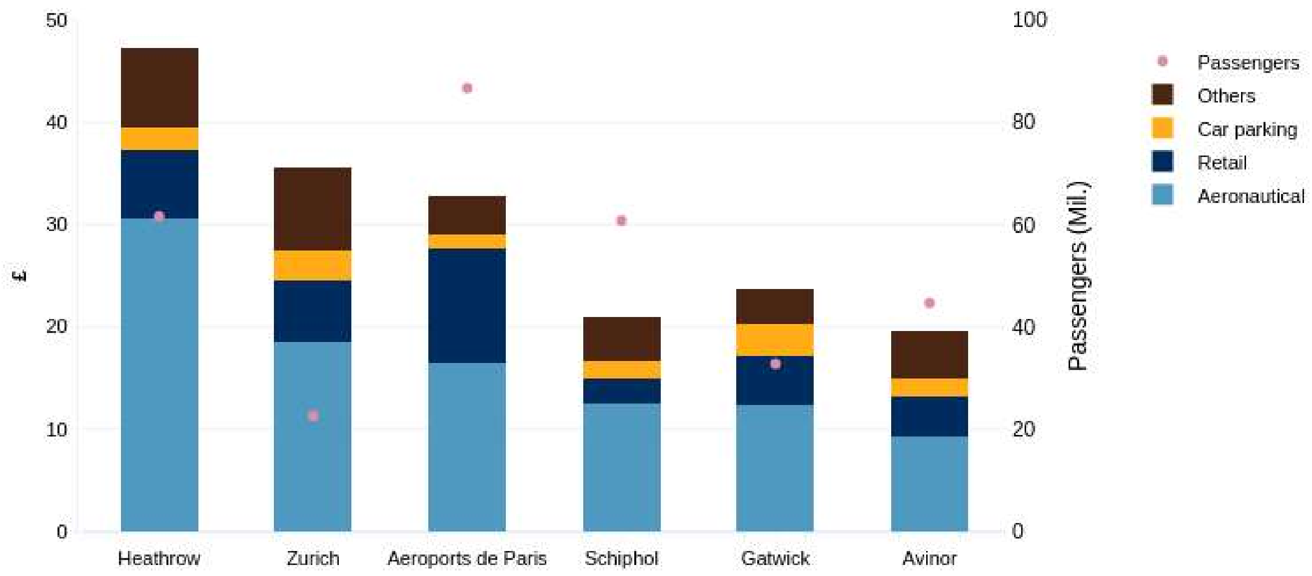
Heathrow is the largest airport in the London area and the hub of the U.K. Worldwide, Heathrow is the fourth busiest airport, being the busiest in Europe. As of March 2023, airport operates with 93% of its total capacity, which is the highest compared with Aeroports de Paris (AdP) and Schiphol airports, the other two European hubs.

Despite operating only one airport with just two runways (by comparison, AdP's Charles de Gaulle has four runways; Paris Orly has three; Amsterdam Schiphol has six), and serving fewer passengers than AdP, Heathrow is the biggest out of these European hubs in terms of revenue and earnings generation. Benefiting from an excellent competitive position, Heathrow has been able to charge the highest aeronautical fees in Europe--£31.57 per passenger in 2023--while other rated airports change less than £20 per passenger. This higher aeronautical charge allows Heathrow to grant its return on investments while continuing to be the most profitable airport. We anticipate that Heathrow's EBITDA margins will remain solid at 50%-55% even after tariffs decrease in 2024.

We view that Heathrow has the largest indebtedness level between the European hubs and other rated airports in the continent. Despite of the stronger profitability than its peers, high debt means that Heathrow's credit metrics are the most leveraged as well--FFO to debt for Heathrow ended 2022 at 4.5%. This compares with 16.1% for AdP and 7.2% for Schiphol.

Revenue per passenger

2022



Source: S&P Global Ratings.

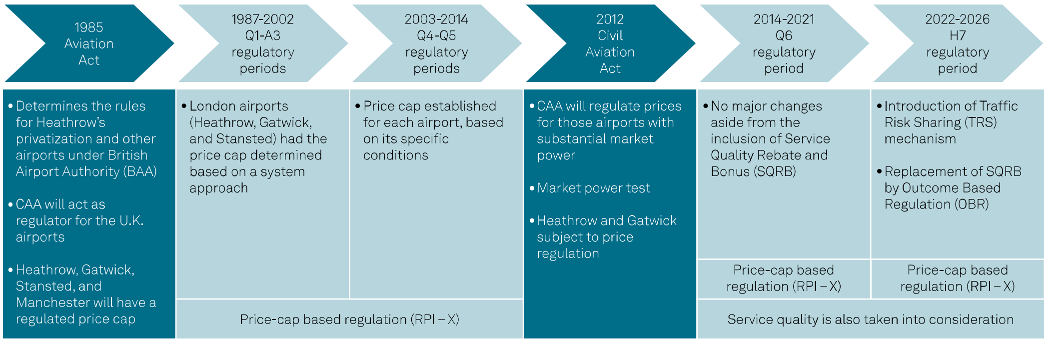
Heathrow Funding Ltd.--Peer Comparisons

	Heathrow Funding Ltd.	Aeroports de Paris	Royal Schiphol Group N.V.
Foreign currency issuer credit rating	--	A/Negative/--	A-/Stable/A-2
Local currency issuer credit rating	--	A/Negative/--	A-/Stable/A-2
Period	Annual	Annual	Annual
Period ending	2022-12-31	2021-12-31	2021-12-31
Mil.	GBP	GBP	GBP
Revenue	2,913	2,332	686
EBITDA	1,684	674	77
Funds from operations (FFO)	677	472	(12)
Interest	888	224	71
Cash interest paid	1,006	249	87
Operating cash flow (OCF)	1,507	454	(70)
Capital expenditure	442	433	371
Free operating cash flow (FOCF)	1,065	20	(442)
Discretionary cash flow (DCF)	(45)	16	(442)
Cash and short-term investments	1,833	1,998	1,041
Gross available cash	1,833	1,998	1,041
Debt	15,043	7,725	3,612
Equity	(6,200)	3,507	2,966
EBITDA margin (%)	57.8	28.9	11.2
Return on capital (%)	11.4	0.1	(1.8)
EBITDA interest coverage (x)	1.9	3.0	1.1
FFO cash interest coverage (x)	1.7	2.9	0.9
Debt/EBITDA (x)	8.9	11.5	47.1
FFO/debt (%)	4.5	6.1	(0.3)
OCF/debt (%)	10.0	5.9	(1.9)
FOCF/debt (%)	7.1	0.3	(12.2)
DCF/debt (%)	(0.3)	0.2	(12.2)

Business Risk

Heathrow operates under a broadly stable and proven regulatory framework that has been in place for over 35 years. The regulatory framework for Heathrow was established in 1987 when the U.K. airport sector was privatized.. The current regulatory period, H7, spans 2022-2026. Although changes in the parameters occur from one regulatory period to the next, the overall framework remains consistent with the principles of affordability and feasible financing. In our view, the framework is transparent and benefits from its long track record.

Heathrow's regulatory framework timeline

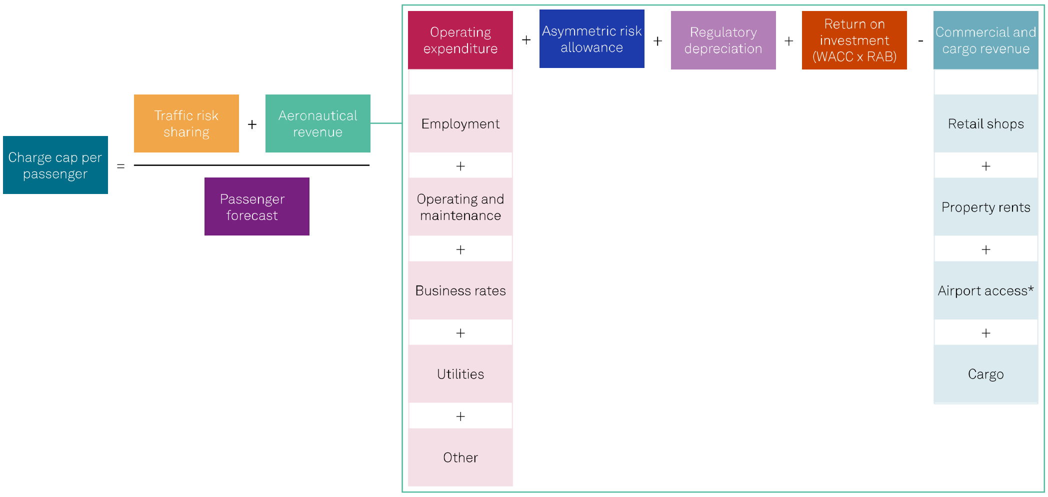


CPI--Consumer price index. RPI--Retail price index. Source: S&P Global Ratings.

The implementation of the H7 final decisions is taking longer than expected--Q6 was extended until the end of 2021 even though it was supposed to be in place at end-2019. The unprecedented ramifications of the COVID-19 pandemic shifted the focus of the H7 discussion from Heathrow's expansion to the sustainability of the airport's profitability during the ramp-up of passenger volumes.

The backbone of the regulation is still a single-till framework that considers the remuneration of the regulatory asset base (RAB), which provides a high degree of transparency and predictability. CAA sets the WACC that will determine the return on the RAB. The latter is in turn annually adjusted by inflation. We note, however that although the CAA maintained the retail price index (RPI) as the index for RAB adjustment during H7, the regulator has indicated the migration to the consumer price index (CPI) in other determinants, as the charge cap, following the U.K. government's plans to overhaul RPI.

Charge cap formula for Heathrow

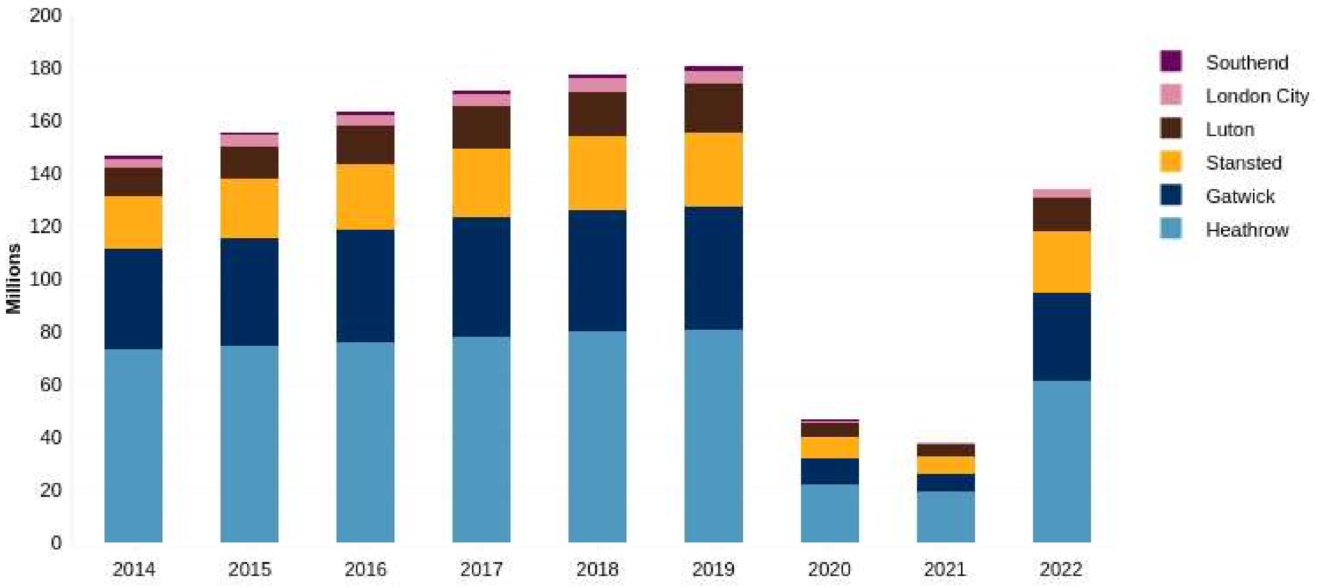


*Airport access comprises rail, car park, and drop-off charge. CPI--Consumer price index. RAB--Regulatory asset base. RPI--Retail price index. WACC--Weighted average cost of capital. Source: S&P Global Ratings.

Heathrow's operating performance is underpinned by the large and attractive catchment area with a wealthy clientele and a demand for direct long-haul services. It is the largest airport serving the London area. The catchment area also includes a significant number of major global companies and the administrative center of the U.K. government. The combined passenger traffic at the five main London airports significantly exceeds that of any other city in the world, and the traffic at the top three airports (Heathrow, Gatwick, and Stansted) is still larger than New York. Heathrow handles about 45% of the traffic in the Greater

London area and about 30% of the total traffic in the U.K. The catchment area covers 25 million people (38% of the U.K. population) within a two-hour drive.

Passengers At London Airports

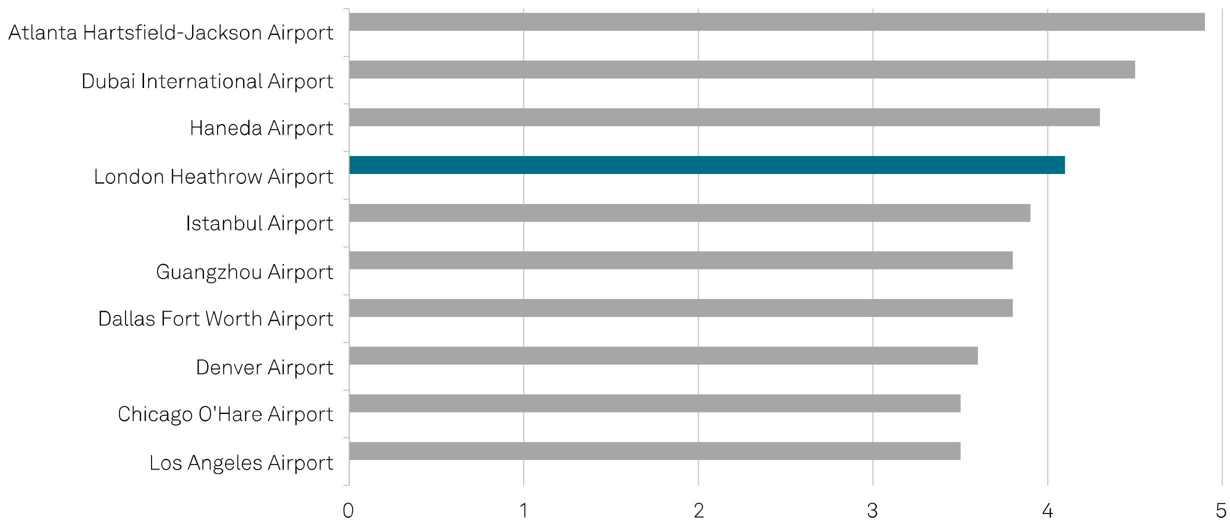


Source: S&P Global Ratings.

Heathrow is likely to remain one of the busiest airports in the world. It is the busiest in the U.K. and Europe, and the fourth busiest worldwide, with low competition from other airports and transportation links. Competition for air traffic from other means of transportation is limited as rail and bus services serve mainly national destinations, with international rail services limited to countries close to the U.K. such as France, Belgium, and Netherlands.

Top 10 Busiest Airports Worldwide

By millions of seats, as of April 2023



Source: Data from OAG.

As Europe's main hub airport, Heathrow benefits from ahigh proportion of long-haul passengers; at about 53% in 2022, the volume was higher than other airports in Europe. Long-haul passengers are less price sensitive and tend to generate more retail revenue since they spend more time at the airport before boarding. In 2022, Heathrow's long-haul traffic was equivalent to 75.8% of 2019 levels, while short-haul reached 76.6%. The airport serves more than 80 airlines, operating scheduled flights to more than 200 destinations worldwide, most of them long-haul routes. Heathrow is the main base airport where British Airways PLC (BA: BB+/Stable/--) operates; the airline represents about 45% of its passenger volumes.

The slots at Heathrow continue to be highly solicited. During the pandemic, when the slot rule was relaxed, BA chose to focus its operations at Heathrow, leaving the slots at other London airports unused, but still under the airline's possession. As demand for travel recovers, so must the load factors at Heathrow, which ended 2022 at 77% versus 80% in 2019.

Financial Risk

Lower charge cap from 2024 on will leave credit metrics headroom thin for the current ratings. We anticipate a solid financial performance in 2023, with FFO to senior debt standing at 8.5%-9.5% and FFO to debt of 6.5%-7.5%. Tariffs will be at £31.57 per passenger, while passenger levels will range between 72.5 million and 75.0 million. This should result in a strong cash flow at the airport, even with higher costs mostly related with hiring new employees to face the growing demand. Inflation impact over accretion should have a smaller impact than in 2022 due to lower inflation expectation for this year and the early repayment of £490 million in accretion that Heathrow made last year. During 2024 and 2025, FFO to senior debt should drop to 7.0%-8.0% and FFO to debt will reduce to 5.0%-6.0%, as Heathrow's tariffs will shrink about 20%. The charge cap will drop from £31.57 (£26.06 as of 2020 prices) per passenger in 2023 to £25.50-£26.00 in 2024 and £26.00-£26.50 in 2025 (£21.03 as of 2020 prices), adjusted by the consumer price index (CPI) during 2023 and the expectation for 2024. Passenger volume increases will not be sufficient, in our view, to counterbalance the tariff reduction. This will put additional pressure on Heathrow to deliver an operational standard in line or better than what the regulator expects for the remainder of the H7.

Heathrow can present negative free operating cash flows. We expect Heathrow will have close to £4.0 billion in capital expenditure (capex) during the remainder of H7. This might need to be financed through additional debt because of the company's lower cash flow from 2024. We will monitor Heathrow's cost efficiencies and the cash outflows from the ring-fenced structure to assess its financial flexibility and the impact on credit metrics. Because Heathrow's management has committed to sustaining its creditworthiness at the current level, we expect it to maintain sufficient financial flexibility in the next years. The lower tariffs from 2024 show that the H7 will be a tough regulatory period for Heathrow, suggesting management will tighten its financial policy in order to maintain credit metrics. as such, we do not expect material cash outflows from the ring-fenced structure, aside from the interest payments on the debentures with Heathrow Finance.

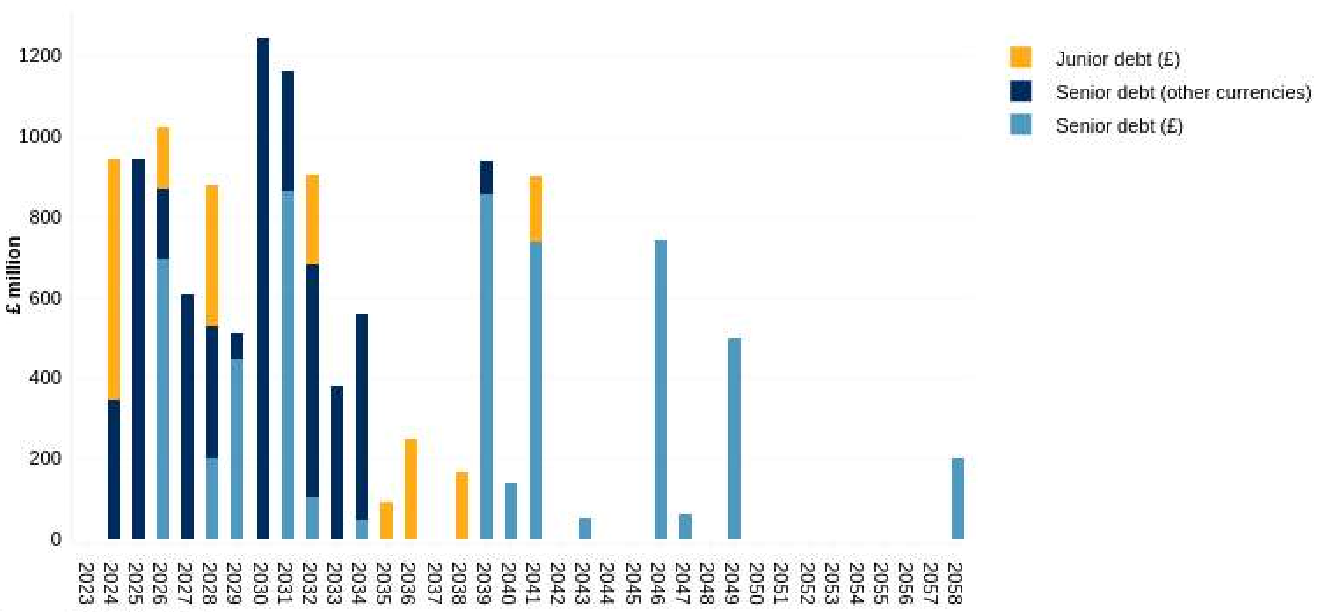
We treat the £2.5 billion intercompany loan between Heathrow (SP) Ltd. and Heathrow Finance PLC-- a holding company outside-- the ring-fenced financing group--as equity. The equity treatment reflects that this loan is subordinated and cannot cause a default on the group's secured debt, and that payments are restricted to distribution and the event of covenants defaults in favor of the secured creditors

Debt maturities

The weighted-average life of the debt at Heathrow (SP) Ltd. is 10.3 years. The company has been lengthening its maturity schedule to keep its commitment with a weighted-average maturity of the debt higher than 10 years.

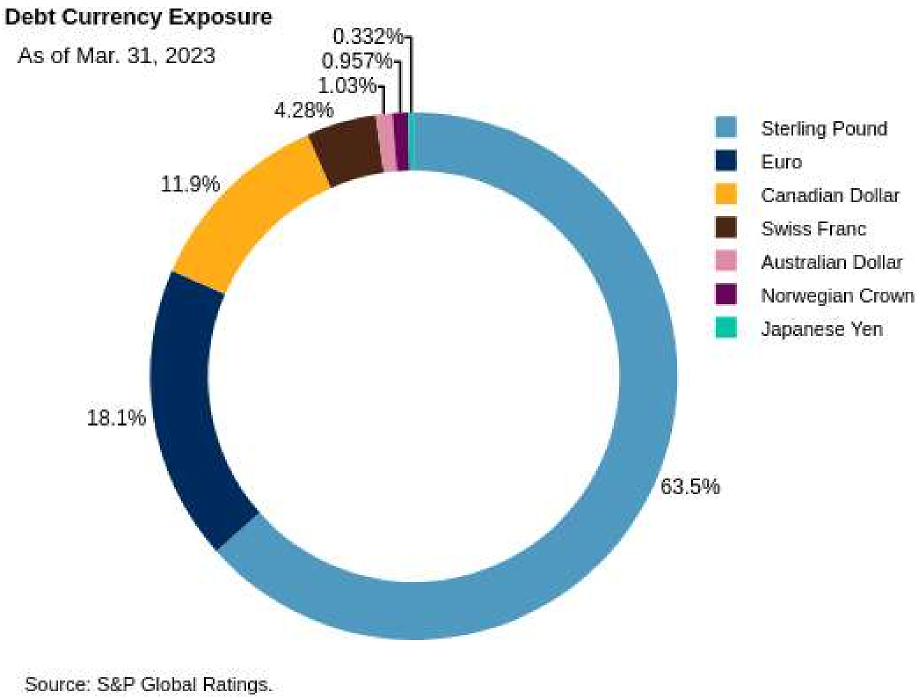
Debt Maturity Profile

As of Mar. 31, 2023



Source: S&P Global Ratings.

Most of the debt that Heathrow issued is in sterling pounds (£), which is the same currency of its cash flow. Despite the foreign currency exposure derived from Heathrow's access to foreign markets for its Class A debt, the company maintains hedge contracts to protect for 100% of foreign currency fluctuations.



About 15% of Heathrow's total debt is inflation-linked--on an annual basis, the value of the debt is adjusted by the retail price index (RPI) and the inflation adjustment is accrued until the maturity of the debt. Considering that tariffs are now adjusted by CPI, which is generally below RPI, we could expect this part of the debt to increase faster than revenues. We will monitor Heathrow's next steps in relation to this mismatch, also considering that RPI will cease to exist by 2030.

Structural Features

The ring-fence includes approximately 13% of junior debt (Class B) that protects senior debtholders. HFL will continue to service Class B debt as long as there is cash. Given the Class B debt's subordinated status, HFL can defer the principal and interest on Class B indefinitely if there is cash shortfall. Furthermore, the Class A debt benefits from stronger senior-only credit metrics. This supports our assessment that the 'bbb' stand-alone credit profile (SACP) on the senior debt is one notch higher than the 'bbb-' SACP on the subordinated debt. Our 'BBB+' rating on HFL's Class A debt also incorporates a one-notch uplift from the 'bbb' SACP on Heathrow (SP) Ltd.'s SACP, reflecting structural features designed to increase cash-flow certainty for debtholders. The 'BBB-' rating on the subordinated Class B debt reflects the 'bbb-' SACP. HFL's structural features include:

- Restrictions on business activities, mergers, acquisitions, and business transformation;
- Covenants restricting dividends and other subordinated payments from the financing group, and a restriction on raising additional senior debt;
- A dedicated liquidity facility sized to cover 12 months of senior interest and six months of junior interest, available to the issuer (HFL) and the borrower Heathrow; and
- A prudent hedging policy and provisions, mitigating refinancing risk.

We apply our ratings-to-principles approach to HFL, using our criteria "Rating Structurally Enhanced Debt Issued By Regulated Utilities And Transportation Infrastructure Businesses," published Feb. 24, 2016. HFL does not meet all the requirements to be rated under our structurally enhanced debt criteria, due primarily to higher volume risk and the absence of a credit remedy period after triggering an event of default on the intercompany loan, during which creditors take control of the business and stabilize its credit quality or sell the company's shares. However, HFL benefits from the right for creditors to step in and appoint an administrative receiver while the business may still retain significant value before default on HFL's debt.

The combination of these factors leads, in our view, to a marginal reduction in the default risk of HFL, similar to the marginal default risk reduction from which SED senior bondholders can benefit.

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)

Reconciliation Of Heathrow Funding Ltd. Reported Amounts With S&P Global Adjusted Amounts (Mil. GBP)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2022									
Company reported amounts	18,203	(6,200)	2,913	1,684	859	1,009	1,684	1,719	-	442
Cash taxes paid	-	-	-	-	-	-	(1)	-	-	-
Cash interest paid	-	-	-	-	-	-	(212)	-	-	-
Cash interest paid: other	-	-	-	-	-	-	(794)	-	-	-
Lease liabilities	378	-	-	-	-	-	-	-	-	-
Postretirement benefit obligations/ deferred compensation	102	-	-	-	-	-	-	-	-	-
Accessible cash and liquid investments	(1,833)	-	-	-	-	-	-	-	-	-
Capitalized interest	-	-	-	-	-	44	-	-	-	-
Nonoperating income (expense)	-	-	-	-	28	-	-	-	-	-
Reclassification of interest and dividend cash flows	-	-	-	-	-	-	-	(212)	-	-
Debt: Derivatives	726	-	-	-	-	-	-	-	-	-
Debt: Shareholder loans	(2,533)	-	-	-	-	-	-	-	-	-
D&A: Asset valuation gains/(losses)	-	-	-	-	69	-	-	-	-	-
D&A: Impairment charges/ (reversals)	-	-	-	-	(14)	-	-	-	-	-
Interest: Shareholder loan	-	-	-	-	-	(165)	-	-	-	-
Dividends: other	-	-	-	-	-	-	-	-	1,110	-
Total adjustments	(3,160)	-	-	-	83	(121)	(1,007)	(212)	1,110	-
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	15,043	(6,200)	2,913	1,684	942	888	677	1,507	1,110	442

Liquidity

Heathrow's liquidity position remains strong, in our opinion. We estimate that its liquidity sources surpass uses by about 2.0x in the next 12 months and by more than 1.2x in the next 24 months. This is a result of Heathrow's efforts to contain cash burns as the airport has not yet fully recovered its passenger volumes. Additionally, because Heathrow will focus its investments on maintenance in the coming years, we expect the airport to sustain financial flexibility.

Moreover, we consider Heathrow's generally high standing in credit markets, as demonstrated by a well-established program for debt issuance at various structural levels (senior, junior, holding company) in several countries and currencies (including the British pound, euro, Japan Yen, Canadian dollar, Australian dollar, Norwegian krona, and Swiss franc), and by solid relationships with numerous banks providing various facilities (including Morgan Stanley, Natwest Markets plc, HSBC Bank plc, Lloyds Bank plc, BNP Paribas, National Australia Bank Ltd., Canadian Imperial Bank of Commerce, and JPMorgan Chase, among others). In our view, the airport's excellent competitive market position and the supportive regulatory framework should enable Heathrow to absorb a high-impact event without refinancing.

Principal liquidity sources

- Unrestricted cash and short-term investments of about £1.8 billion;
- £1.4 billion undrawn credit facilities; and
- Cash FFO of about £1.2 billion.

Principal liquidity uses

- Debt maturities of about £750 million;
- Investments of £650 million-£700 million; and
- Interest payments on the debentures to HFL of £150 million-£200 million.

Covenant Analysis

Requirements

The Class A debt has financial covenants measured at Heathrow (SP) Ltd.'s level that could lead to an event of default if not in compliance, as follows:

- Senior interest coverage ratio of at least 1.05x, calculated based on the average of the three previous years; and
- Senior regulatory asset ratio below 92.5%.

Additionally, both the Class A and Class B debt must comply with the following ratios, otherwise there would be a lock-up for distributions at Heathrow (SP) Ltd.:

- Senior interest coverage ratio higher than 1.40x;
- Junior interest coverage ratio higher than 1.20x;
- Senior regulatory asset ratio below 72.5%; and
- Junior regulatory asset ratio below 85.0%.

Compliance expectations

In our base-case scenario, we expect the company will comply with the financial covenants over the next 24 months. Higher passengers, almost approaching a full recovery to 2019 levels, should result in enough cash flow to sustain the required covenants in compliance.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5
- N/A				

S-1	S-2	**S-3**	S-4	S-5
- Health and safety				

G-1	**G-2**	G-3	G-4	G-5
- 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 alphanumerical 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 February 2023, passenger volumes reached 94.5% of 2019 levels, thanks to a rebound in both short- and long-haul flights. Furthermore, the reopening of China's borders should contribute 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 (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 features	**+1 notch**	**None**

Related Criteria

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

Related Research

- 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
- Heathrow Funding Class A 'BBB+' And Class B 'BBB-' Ratings Affirmed On CAA Decision; Off CreditWatch; Outlook Stable, March 22, 2023
- Industry Top Trends 2023: Transportation Infrastructure, Jan. 23, 2023
  Europe's Remarkable Air Passenger Traffic Recovery Faces A Trickier 2023, Nov. 21, 2022

Ratings Detail (as of May 05, 2023)*

Heathrow Funding Ltd.	
Senior Secured	BBB+/Stable
Subordinated	BBB-/Stable

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.