

Tear Sheet:

Heathrow Funding Ltd.

October 27, 2023

Heathrow Funding Ltd.'s (Heathrow's) strong results in the first nine months of 2023 partly mitigate the early settlement of inflation accretion on its index-linked debt. The company's revenues increased by 30.1% to £2.7 billion and its EBITDA by 35.9% to £1.7 billion in the first nine months of the year, thanks to a recovery in passenger volumes, aeronautical charges of £31.57 per passenger, and average spending per passenger of £8.65. This should enable the company to achieve our forecast of £3.4 billion-£4.0 billion in revenues and £2.0 billion-£2.2 billion in EBITDA in 2023.

On the other hand, persistently high inflation this year has slowed the recovery in Heathrow's credit metrics to pre-pandemic levels. This is mainly due to settlement payments relating to inflation accretion on the company's index-linked debt, which roughly comprises 25% of its total debt stock. We incorporate these payments into our calculation of Heathrow's adjusted funds from operations to debt, and this is having a negative bearing on the metrics. We expect this to consume the headroom that we previously expected for Heathrow's 2023 metrics, such that the metrics should end the year closer to our rating thresholds. We now expect Heathrow's FFO to senior debt to be 7.0%-8.0% and its FFO to debt 5.0%-6.0%, down from our previous expectations of FFO to senior debt of 8.5%-9.5% and FFO to debt of 6.5%-7.5%.

The Competition and Markets Authority's (CMA's) final determination is in line with our expectations of a 20% drop in aeronautical charges. On Oct. 17, 2023, the CMA ruled on the aspects of the H7 price control period that Heathrow and three airline carriers had appealed. While the CMA has broadly found in favor of the CAA, there are a few minor aspects of its pricing decision that it has asked the CAA to reconsider before the implementation in 2025. In our view, these aspects should not materially change the CAA's final decisions. Our base-case operating assumptions remain the same as in July 2023, with aeronautical charges in the range of £26.50-£27.00 per passenger in 2024 and £27.00-£27.50 per passenger in 2025, equivalent to the CAA's announcement of a £21.03 real aeronautical tariff, as per 2020 prices.

Passenger numbers are stronger than we anticipated. Until September 2023, 59.4 million passengers used Heathrow airport, mostly for leisure travel. This was equivalent to 97.4% of 2019 levels and 34.4% of levels in the same period last year. Despite macroeconomic uncertainties, we expect passenger volumes to continue growing in the last months of 2023, considering the strong summer season and the usual increase in travel over the Christmas break. Based on the strong passenger volumes, we have slightly increased our passenger forecast for this year to about 78.5 million from 76.5 million previously. Additionally, we consider that Heathrow might achieve passenger numbers of between 79.0 million and 80.9 million in 2024, and between 80.9 million and 82.9 million in 2025. This means that a full recovery to 2019 levels could occur in 2024.

Primary contact

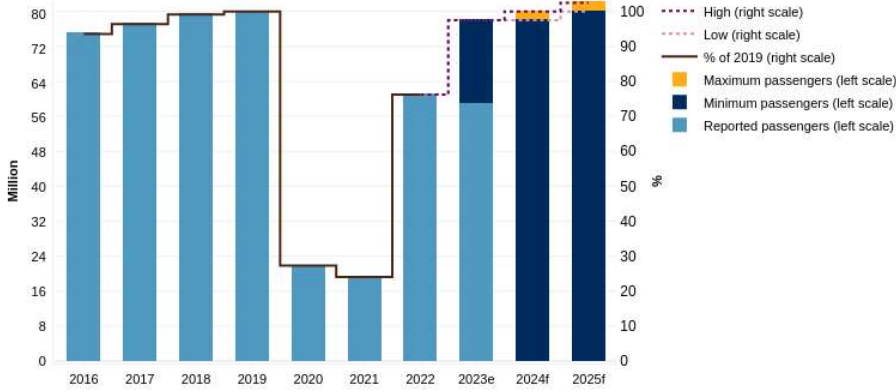
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Heathrow Funding Ltd.

Passengers at Heathrow continue to rebound
In millions and as a % share of 2019



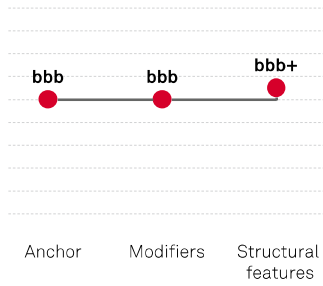
Source: S&P Global Ratings.

Ratings Score Snapshot

Business risk: **Excellent**



Financial risk: **Aggressive**



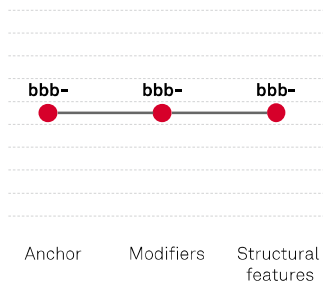
BBB+/Stable

Class A Issue Rating

Business risk: **Excellent**



Financial risk: **Highly Leveraged**



BBB-/Stable

Class B Issue Rating

Recent Research

- Tear Sheet: Heathrow Funding Ltd., July 27, 2023
- Industry Top Trends Update Europe: Transportation Infrastructure, July 18, 2023
- European Air Travel Defies Economic Pressures On Robust Demand, June 7, 2023

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- 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) 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 Heathrow.

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

In the first nine months of 2023, Heathrow reported revenues of £2.7 billion and EBITDA of £1.7 million, while its cash position was £1.8 billion--more than its debt maturities of £953 million in the following 12 months.

Outlook

The stable outlook reflects our view that, despite lower tariffs and higher investments, Heathrow will be able to achieve 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 in 2026. This is based on greater certainty on the tariff for H7, a recovery in passenger volumes, 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 of 7.0% or FFO to junior debt of 5.0%, with no immediate likelihood of recovery. This could happen, for example, if:

- There are significant cash outflows from the ring-fenced structure, in addition to the interest payments relating to the debentures with Heathrow Finance PLC. Such outflows could include the partial repayment of the debentures with Heathrow Finance, or the distribution of dividends to shareholders, resulting in a less supportive financial policy.
- Inflation fails to return to a long-term average of 2.0% and Heathrow is not able to mitigate the negative effects of this.

Upside scenario

In our view, ratings upside is 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 if Heathrow increases its commercial revenues and reduces its operating expenses to be in line with, or more efficient than, the CAA anticipated in its final decisions.

Key Metrics

Heathrow Funding Ltd.--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	97.5	97.5-100	100-102.5
Passengers (million)	80.9	61.6	78.5	78.5-80.9	80.9-82.9
Charge cap (£ per passenger)	23.18	30.19	31.57	26.50-27.00	27.00-27.50
Revenue	3,070	2,913	3,400-4,000	2,900-3,600	3,100-3,700
EBITDA	1,924	1,684	2,000-2,200	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	7.0-8.0	7.0-8.0	7.0-8.0
FFO/debt (%)	9.0	4.5	5.0-6.0	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)

Heathrow Funding Ltd.--Financial Summary

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-1	A+/Stable/--
Local currency issuer credit rating	--	A/Negative/--	A/Stable/A-1	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	248	479
Interest	888	235	68	20
Cash interest paid	1,006	245	71	15
Operating cash flow (OCF)	1,507	1,173	314	427
Capital expenditure	442	600	403	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	4.5	34.0
Debt/EBITDA (x)	8.9	5.2	10.2	2.3

Heathrow Funding Ltd.--Peer Comparisons

FFO/debt (%)	4.5	16.1	7.4	41.0
OCF/debt (%)	10.0	14.3	9.3	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

Social factors are a moderately negative consideration in our credit analysis of Heathrow. Passenger volumes continue to recover to pre-pandemic levels. In September 2023, passenger volumes reached 97.4% of 2019 levels, thanks to a rebound in both short- and long-haul flights. Furthermore, the reopening of China's borders in March 2023 has been contributing to an increase in long-haul passengers at Heathrow. Conversely, the rising cost of living due to macroeconomic headwinds could derail the 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
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019

Heathrow Funding Ltd.

- 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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