MOODY'S
INVESTORS SERVICE

CREDIT OPINION
6 July 2017

Update

Rate this Research

RATINGS

Avinor AS

Domicile	Norway
Long Term Rating	A1
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Avinor AS

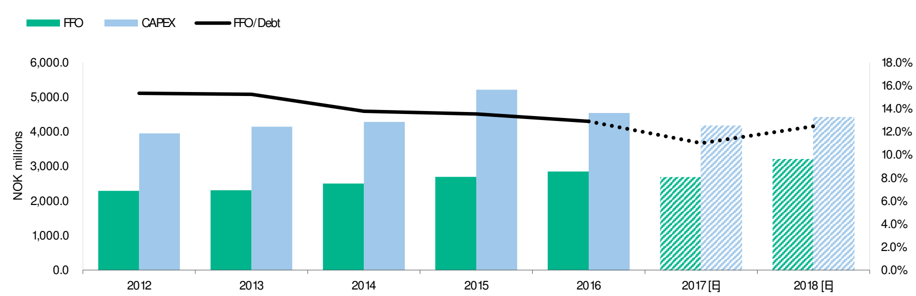
Update to reflect continued high levels of capital expenditure

Summary Rating Rationale

Avinor AS (Avinor)'s A1 rating positively reflects (1) Avinor's strong business profile, on account of its near monopoly position and modest transmodal competition for medium-long distance travel within Norway; (2) a supportive strategic framework established by the State which reflects the importance of Avinor's operations to achieve societal objectives; (3) a high share of origin and destination traffic, which is, however, concentrated among a relatively small number of airlines; (4) a conservative financial policy; and (5) a three-notch uplift because of the likelihood of extraordinary support being provided by the Government of Norway in the event that this were ever to be required to avoid a default.

However, the rating also reflects the following challenges: (1) Avinor's exposure to Norway's currently sluggish economic environment, which affects aeronautical and commercial revenue growth; and (2) a significant capital expenditure programme which entails investment of approximately NOK26.7 billion during the period 2017-2022.

Exhibit 1
Moody's adjusted FFO and Capital expenditure (NOK million, LHS) and FFO / debt (%, RHS)



The 2017 and 2018 estimates represent Moody's forward view; not the view of the issuer
Source: Moody's Financial Metrics for historical data.

Credit Strengths

» Monopolistic position and modest transmodal competition

» Supportive strategic framework

» High share of origin and destination traffic, albeit serviced by relatively few airlines

» Conservative financial policy

» Likelihood of support from the Kingdom of Norway, should it become necessary

Credit Challenges

» Exposure to Norway's sluggish economic environment, which negatively impacts revenue growth

» Significant capital expenditure programme

Rating Outlook

The stable outlook assigned to the rating reflects the near monopoly position of Avinor and the strategic importance of Avinor's airport and air navigation operations to Norway.

Factors that Could Lead to an Upgrade

Upward rating pressure could develop if Avinor's Cash Interest Coverage Ratio was consistently higher than 5x and Funds From Operations (FFO) / Debt were to be in the high teens in percentage terms on a sustained basis.

Factors that Could Lead to a Downgrade

The rating could come under downward pressure if (i) the capital investment programme were to experience delay and/or overruns; or (ii) Avinor's Cash Interest Coverage Ratio fell below 4.0x and the FFO / Debt ratio declined to below 10% on a sustained basis. Furthermore, any downwards move in the Government of Norway's credit rating could put downward pressure on Avinor's rating.

Key Indicators

Exhibit 2
Avinor AS

	12/31/2016	12/31/2015	12/31/2014	12/31/2013	12/31/2012
(FFO + Cash Interest Expense) / (Cash Interest Expense)	4.9x	4.7x	4.6x	4.4x	4.7x
FFO / Debt	12.9%	13.5%	13.8%	15.2%	15.3%
Moody's Debt Service Coverage Ratio	4.3x	4.2x	4.1x	4.4x	4.1x
RCF / Debt	10.6%	11.0%	11.3%	12.2%	12.5%

All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Detailed Rating Considerations

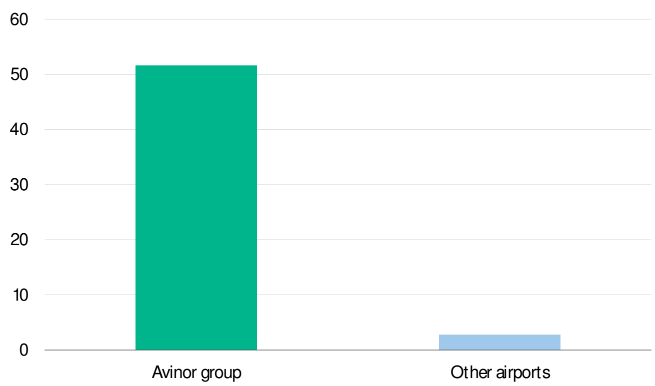
Monopolistic position and modest transmodal competition

Avinor is a limited liability company subject to normal laws, albeit 100% owned by the Government of Norway. It is classified in Norway as a category 4 company on the scale of State-owned enterprises, and is thus viewed as an important entity by the State, on the basis that it fulfils “national sectoral political” objectives. Avinor owns and operates 46 airports in Norway, and its management controls all key aviation infrastructure.

Avinor is the sole provider of air navigation services within Norwegian airspace and has a virtual monopoly of air travel originating and ending in Norway capturing approximately 99% of domestic passengers and approximately 90% of international passengers. International airports in other Scandinavian countries are not readily accessible to the Norwegian population. Whilst other forms of transport are used in the south of Norway, the topography of the country and the large distances between population centres means that air travel is by far the most efficient mode of travel. Fast rail connections are limited to the Oslo region and cover a relatively short distance. The location of Norway on the periphery of Europe means that air travel is largely required when travelling internationally.

Exhibit 3

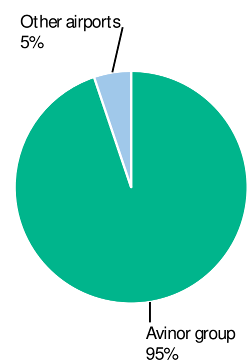
Passenger traffic at Norwegian airports in 2016 (million passengers)



Source: Avinor AS

Exhibit 4

Market shares of the Avinor group and other airports in Norway in 2016



Source: Avinor AS

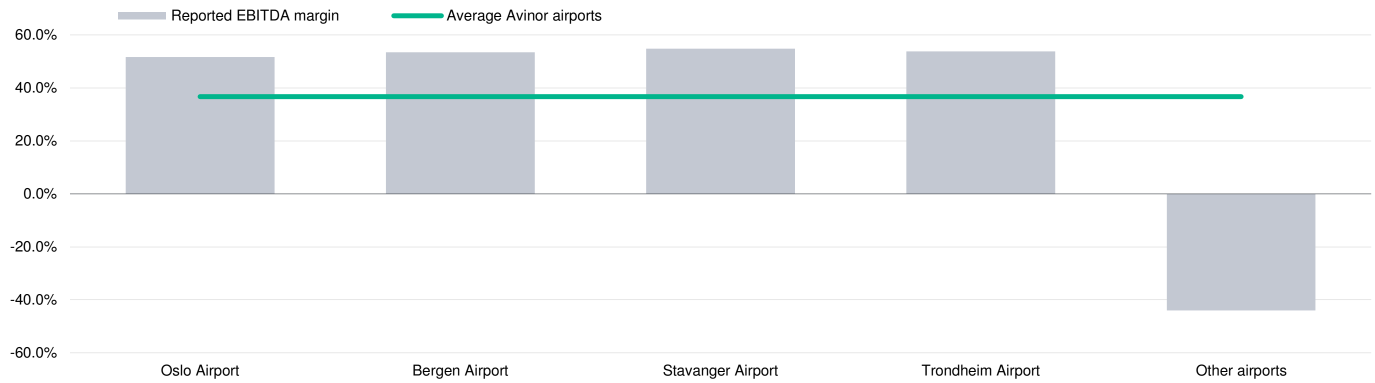
Thanks to the geographical reach of the Avinor network, two out of three Norwegians have access to an airport within an hour's travel and 99.5% of the country's population is able to visit the capital Oslo and return home on the same day.

Supportive strategic framework

The Kingdom of Norway, via the Norwegian Ministry of Transport and Communications ("MoTC"), controls 100 percent of the share capital of Avinor. As owner, the State has established that Avinor should operate in such a way as to support the population of Norway in providing a vital form of transport, rather than as a profit maximizer. Avinor reports EBITDA margins for its airports division that are lower than those of other European airport companies. In fact, a more granular analysis of the profitability of Avinor airports shows that the four largest airports (which together represent more than three quarters of traffic in the network) achieve high levels of EBITDA margins, comparable and in some cases higher than those reported by some of the most profitable airport groups in Europe. Avinor airports’ average profitability is in fact dragged down by the operation of a number of loss-making regional and local airports in response to social objectives set by the government, rather than to strict profit motives. The Norwegian government is effectively using those large profitable airports to subsidise the operation of small unprofitable airports.

Exhibit 5

Reported EBITDA margins at Avinor's four largest airports and the rest of the network in 2016



Source: Avinor AS

Nevertheless, the State does not have an active role in the day to day management of the company and requires Avinor to operate as a commercial entity with management and a Board that comprise experienced commercial professionals rather than civil servants.

Strategic objectives are outlined in the Ten-Year Transportation Plan, with specific operational and financial requirements set out in the Avinor Ownership Report. These documents are effectively government policy documents, rather than a formal charter. They set out that the focus for Avinor should be on quality improvements for, and financial returns from, the airport network and air navigation system in Norway. In the latest iteration of the Ownership Report, the Norwegian government has announced its desire to separate the air navigation system and the airport operation activities and has asked Avinor to prepare the disposal of the air navigation subsidiary by 2021.

The State also has a role in aeronautical rate-setting. Although Norway is not an EU member state, the government has transposed the EU's Airport Charges Directive into Norwegian law. The directive sets out minimum requirements in terms of transparency, consultation with airlines and non-discrimination of charges, and mandates the setting up of an independent supervisory authority.

Since the transposition of the directive, charges are determined using a RAB-based, single-till formula. Regulated revenues are defined as yearly passenger price caps derived from dividing annual passenger forecasts by the sum of (1) the remuneration of an agreed regulatory asset base at a predetermined weighted average cost of capital; and (2) allowances for the recovery of asset depreciation and operating costs; and (3) the netting-off of commercial revenues, although the latest iteration of the Ownership Report states that "in periods of high investment, all commercial profits will not necessarily be used to subsidise airport charges", particularly in situations where the company's self-imposed minimum equity ratio of 40% could be at risk of being breached. The State also requires Avinor to establish a uniform set of aviation charges across its network, which effectively leads to a cross-subsidisation of the marginal rural airports by the more commercially viable larger airports including Oslo, Stavanger, Bergen and Trondheim.

In practice, after consulting with airlines, Avinor management proposes charges in an annual plan which reflects the financial objectives that are outlined in the Ownership Report and the proposed capital investment plans, although the company is exploring with airlines the possibility to set tariffs within a multi-year horizon to smooth changes and provide more visibility to investment planning. Regulatory oversight is exercised by officials at the MoTC.

From a competitive perspective, management and the MoTC also endeavour to set charges at levels that will encourage airlines to develop their route strategies in Norway rather than in nearby competitor countries such as Denmark and Sweden. The State aims to ensure its companies make a fair return on capital employed, although this is not the primary objective of Avinor.

Exposure to Norway's sluggish economic environment, which negatively impacts revenue growth

The total population of Norway is 5.1 million, representing approximately 1% of the total European Economy Area (EEA) population and ranking as 21st in population size within the EEA.

The Norwegian economy can be characterised as a wealthy and well developed economy, with very high standards of living and a cohesive society, as indicated by high GDP per capita figures and some of the lowest levels of income inequality in the world. Norway is routinely ranked near the top of the United Nations' Human Development Index and the Inequality-Adjusted Human Development Index tables.

However, the Norwegian economy is heavily dependent on natural resources, most significantly oil and gas but also hydroelectric power and fishing. Taken together, the oil and gas industries represent around a fifth of Norway's economy and approximately 60% of Norway's exports. This exposes the country to potential economic pressures in times of low commodity prices and lower economic activity can, in turn, have a negative impact on traffic at Avinor's airports.

Over the last decade passenger growth rate has averaged 3.4% per annum across the 46-airport network, whilst growth at Oslo has been slightly higher at 3.9% per annum on average. In addition, compared to most other airports rated by Moody's, Avinor has experienced relatively low volatility of passenger traffic in the last ten years. The standard deviation of the growth rate over the last ten years was 4%.

Traffic growth has, however, been negatively affected by Norway's sluggish economic environment since mid 2014, when crude oil prices began to slide. Between June 2014 and January 2015, crude oil prices decreased by more than 50%. A mild recovery in the first half of 2015 was followed by further declines. Although crude oil prices somewhat recovered in the first half of 2016, they have remained around $50 per barrel since mid 2016, less than half their average levels in June 2014.

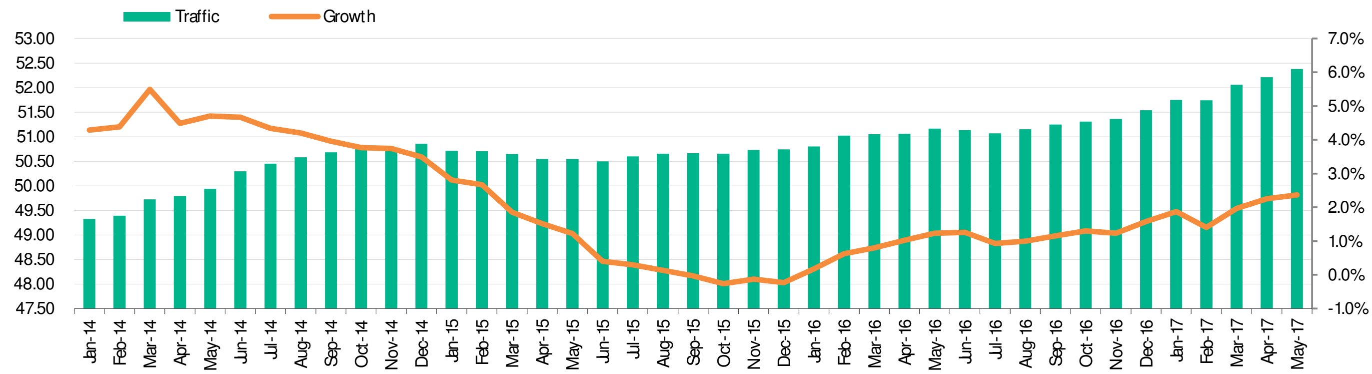
Airports serving cities exposed to the oil industry, such as Stavanger, home to Statoil, the largest oil and gas operator in the Norwegian continental shelf, and Bergen, saw sharp passenger traffic declines in 2015 (-4.6% and -3% respectively). Travel by helicopter to and from oil and gas offshore platforms was also hit by lower levels of activity.

The anticipated and subsequent fall in oil revenues for the country triggered a depreciation of the Norwegian Krone, which increased the cost of holidaying abroad and weighed on the demand for air travel. In addition, although unemployment remains modest by international standards, Norway's unemployment rate increased following the decline in oil prices and has stayed higher than its pre 2014 levels, contributing to reductions in discretionary demand for travel.

The diverse nature of the airports in the Avinor network and an increase in inbound tourism triggered by the Krone's depreciation mitigated the negative impact of lower oil prices, and the network as a whole only saw a modest traffic decline of 0.25% (or c. 0.1 million passengers) in 2015. As the economy stabilised and absorbed the oil price shock, the Avinor network returned to growth in 2016, in spite of the introduction of a NOK80 tax on every departing passenger on 1 June 2016. Although the outlook for the immediate future has improved and passenger growth has accelerated in the first half of 2017, growth levels are still well below the levels the network exhibited prior to June 2014.

Exhibit 6

Passenger traffic volumes (million passengers, LHS) and traffic growth (percentage, RHS) on a 12-month rolling basis since January 2014



Source: Avinor AS

High share of origin and destination traffic, albeit serviced by relatively few airlines

Avinor is regarded as an origin and destination (O&D) airport system. Avinor's proportion of O&D traffic has been above 80% for the last decade. The current proportion of O&D traffic is approximately 82%, which reflects a strong core of traffic and provides for more resilient revenues when compared to transfer traffic.

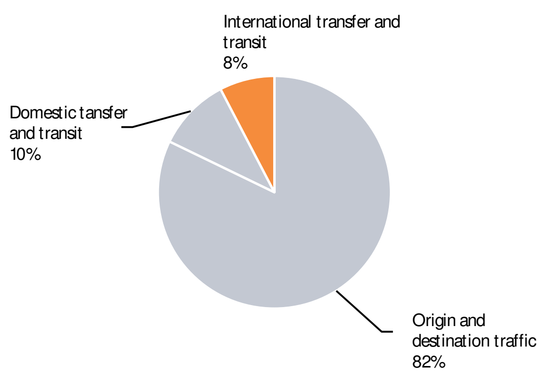
Although total transfer and transit transfer at Avinor represents 18% of total traffic, more than half of the transfer and transit traffic reported by Avinor is internal to the Avinor network (trips between two Norwegian airports with a stopover, typically at Oslo airport).

Given the geographic characteristics of Norway and the importance of air transport for internal mobility, this intra-network transfer traffic behaves more like origin and destination traffic and is expected to be resilient to an airline failure. The proportion of traffic that is therefore at risk in the Avinor network is a more modest 7.6%.

Avinor's carrier base is, however, relatively concentrated, with its two main carriers, SAS and Norwegian, capturing more than three quarters of passenger traffic at Avinor's airports. Given the nature of the traffic on Avinor's network, a failure of either of these airlines would not likely lead to important permanent losses of traffic for the network. However, given the high volume of capacity that would need to be replaced and the relatively small number of carriers already operating at Avinor's airports, it may take some time before the existing demand is serviced by other airlines.

Exhibit 7

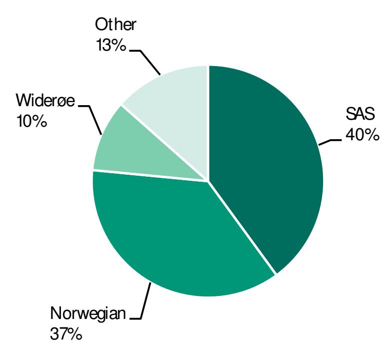
Proportion of traffic potentially at risk of permanent loss in case of major airline failure (2016)



Source: Avinor AS

Exhibit 8

Avinor's carrier base by market share in 2016 (percentage of total passengers transported)



Source: Avinor AS

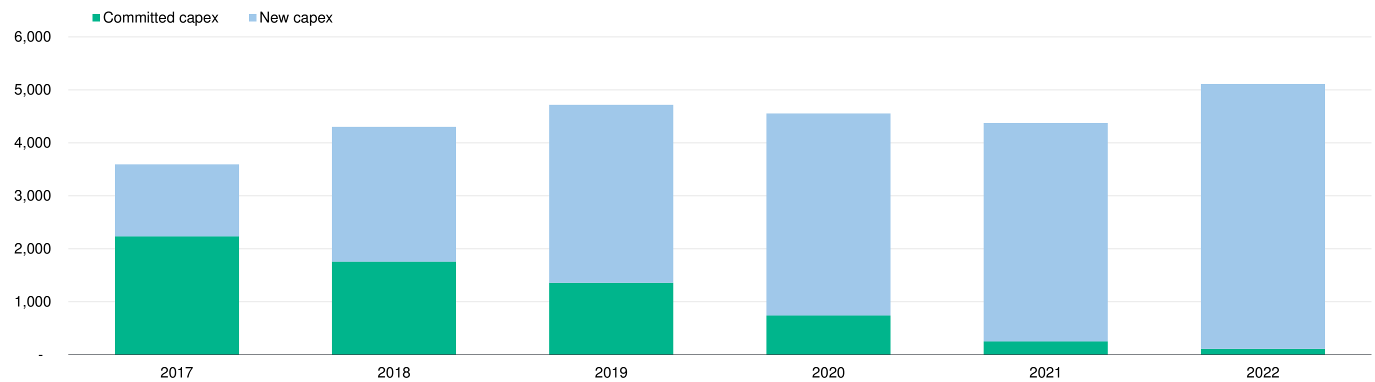
Continued high levels of capital expenditure

Over the last few years, Avinor embarked on an extensive capital programme, which included the delivery of two new terminals (one at Oslo and one at Bergen) for a total budgeted cost of NOK16.4 billion.

Terminal 2 officially opened at Oslo in April 2017, increasing passenger capacity by 50% and offering relief to an airport that was operating close to capacity at peak times. The new terminal at Bergen is expected to open in August 2017 and will almost double the capacity of an airport that is already operating above its efficient capacity.

However, investment levels are not expected to reduce significantly after the completion of these two projects. In fact, total investment levels may increase in 2018 and remain above NOK4 billion per year until 2022. The latest corporate plan includes some NOK20.2 billion of new projects between 2017 and 2022. The new projects notably include several expansionary investments at Oslo airport, such as the expansion of the non-Schengen terminal area, the provision of US pre-clearance facilities, the development of the cargo area or investments in airside facilities to increase slot capacity. As these projects have not yet started and individually are more modest in size than the two ongoing major investments, management could defer or delay some of these investments if the business rationale no longer justified them.

Exhibit 9
Capital expenditure programme 2017-2022 (NOK million)



Source: Avinor AS

Conservative financial policy

Management has indicated that it intends to pursue a conservative financial strategy, in the context of the requirement to finance the major capital programme. The current debt facility from the EIB contains financial covenants requiring an Equity Ratio (defined as Equity : Equity + Net interest bearing debt) of in excess of 30% and places constraints on Avinor's ability to enter into additional indebtedness. Notwithstanding these protections, the company has chosen to target a more conservative 40% minimum equity ratio enshrined in the company's by-laws.

The conservative approach to financial policy is perhaps best exemplified by the company's dividend strategy. Whilst Avinor's FFO / Debt metric has come under pressure as a result of an important investment programme, the company has nonetheless sought to minimise the additional indebtedness needed to finance these investments. To achieve this, Avinor's shareholder, the Norwegian government, has agreed to impose a hard cap of NOK500 million per annum on dividends until 2018. As the company has sold non-core assets, such as hotel businesses located near some of Avinor's airports, the cap on dividends has meant that the proceeds from these sales were used to finance investments rather than extracted in the form of dividends, thereby minimising additional indebtedness. As a result, Avinor's RCF / Debt metric has been broadly stable since 2011, in spite of the notable investment effort and the increased indebtedness.

The government has announced that the dividend cap will cease to apply in 2018, but has recently emphasised that in periods of high investment airport charges may not be fully subsidised by commercial revenues, particularly in situations where the company's self-imposed minimum equity ratio of 40% could be at risk of being breached.

In spite of the improved outlook for traffic, we expect FFO / Debt to decline in 2017, partly due to a series of one-off events including payments following an agreement with the Norwegian armed forces to settle long-standing disputes relating to the use of some airports. FFO / Debt should start to recover from 2018, as the opening of the new terminal facilities should have a positive impact on revenue growth.

High likelihood of support from the Kingdom of Norway, should it become necessary

Moody's categorises Avinor as a Government-Related Issuer as a result of it being wholly owned by the Government of Norway. Moody's therefore applies its Government-Related Issuers rating methodology, published in October 2014. The A1 rating incorporates: (i) our baseline credit assessment of baa1 for Avinor, (ii) our sovereign rating of Norway (Aaa stable); (iii) our assessment of default dependence being Moderate; and (iv) our assessment of the likelihood of extraordinary support being High.

We have assigned three notches of rating uplift from the baseline credit assessment, reflecting the strategic importance of the asset and the recent examples of extraordinary State support including a payment holiday on the State loan provided to Avinor's subsidies, a relaxation of dividend payments in 2009 and 2010 and the recent decision to lower dividend payments to finance capital investments. Although Avinor does not receive direct ongoing State subsidies in contrast to certain other State-owned companies, we note that existing legislative provisions would allow such subsidies to be provided at relatively short notice.

Structural Considerations

After a corporate reorganization, Oslo Lufthavn AS (the company that owns Oslo Gardermoen airport and was 100% owned by Avinor) was merged into Avinor on 11 January 2016, decreasing the proportion of the Avinor Group debt that was structurally subordinated to indebtedness at the subsidiaries' level from c. 30% to less than 10%. Given the low percentage of group debt provided to Avinor's other operating subsidiaries and the relatively limited amount of cash they generate, we do not adjust Avinor's rating to reflect structural subordination.

Liquidity Analysis

In line with other major airport companies, Avinor generates strong operating cash flow throughout the year, albeit with some seasonality because the northern hemisphere summer season generates more cash flow than the winter season. Avinor's projected cash balances and available bank facilities should be sufficient to meet its cash requirements for the next 12 months, and we expect Avinor to maintain good liquidity.

Avinor benefits from a sound liquidity position by virtue of its positive operating cash flows and sizeable undrawn banking lines. The company's current financing strategy is to pursue diversity in terms of sources of credit and to achieve a spread of maturities.

As at 31 March 2017, Avinor had an estimated NOK3.8 billion of cash and cash equivalents and NOK4.8 billion of undrawn banking lines. The largest undrawn line of NOK4 billion is revolving and subject to utilization conditions and is due to mature in June 2020. Additionally, a fully available NOK0.8 billion revolving credit line due November 2017 is in place. Avinor has around NOK634 million of borrowings (excluding commercial paper issuance) due over the next 12 months.

Profile

Avinor is a company that owns and operates a network of 46 airports in Norway, which together handled over 90% of Norwegian passenger traffic in 2016 and is the sole provider of air navigation services to both civilian and military flights within Norwegian airspace. Avinor is 100% owned by the Government of Norway.

Rating Methodology and Scorecard Factors

Avinor's rating reflects our assessment of the company's business profile and financial pe formance in line with Moody's Privately Managed Airports and Related Issuers Rating Methodology, published in December 2014 and Moody's Government-Related Issuers rating methodology, published in October 2014.

Exhibit 10

Avinor AS - Rating Factors Grid

Privately Managed Airports and Related Issuers Industry Grid [1][2]	Current 12/31/2016		Moody's 12-18 Month Forward View As of 7/4/2017 [3]	
Factor 1: Concession and Regulatory Frameworks (15%)	**Measure**	**Score**	**Measure**	**Score**
a) Ability to Increase Tariffs	Baa	Baa	Baa	Baa
b) Nature of Ownership / Control	Aaa	Aaa	Aaa	Aaa
Factor 2: Market Position (15%)				
a) Size of Service Area	Aa	Aa	Aa	Aa
b) Economic Strength & Diversity of Service Area	Aa	Aa	Aa	Aa
c) Competition for Travel	Aaa	Aaa	Aaa	Aaa
Factor 3: Service Offering (15%)				
a) Passenger Mix	Aa	Aa	Aa	Aa
b) Stability of traffic performance	A	A	A	A
c) Carrier Base	Baa	Baa	Baa	Baa
Factor 4: Capacity and Capital (5%)				
a) Ability to accommodate expected traffic growth	Baa	Baa	Baa	Baa
Factor 5: Financial Policy (10%)				
a) Financial Policy	A	A	A	A
Factor 6: Leverage and Coverage (40%)				
a) (FFO + Cash Interest Expense) / (Cash Interest Expense)	4.9x	A	4.5x - 5x	A
b) FFO / Debt	12.9%	Baa	11% - 12.5%	Baa
c) Moody's Debt Service Coverage Ratio	4.3x	Baa	3.5x - 4.2x	Baa
d) RCF / Debt	10.6%	A	8.5% - 12%	A
Rating:				
Indicated Rating from Grid Factors 1-6		A3		A3
Rating Lift	**0.0**	**0.0**	**0**	**0.0**
a) Indicated Rating from Grid		A3		A3
b) Actual Baseline Credit Assessment Assigned				baa1
Government-Related Issuer	**Factor**			
a) Baseline Credit Assessment	baa1		baa1	
b) Government Local Currency Rating	Aaa		Aaa	
c) Default Dependence	Moderate		Moderate	
d) Support	High		High	
e) Final Rating Outcome	A1		A1	

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2016. [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures

Source: Moody's Financial Metrics

Ratings

Exhibit 12

Category	Moody's Rating
AVINOR AS	
Outlook	Stable
Issuer Rating -Dom Curr	A1
Senior Unsecured	A1

Source: Moody's Investors Service

REPORT NUMBER 1080490

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