MOODY'S
INVESTORS SERVICE

ISSUER IN-DEPTH
24 May 2016

Rate this Research

RATINGS

Avinor AS

Long Term Issuer Rating	A1
Senior Unsecured	A1
Baseline Credit Assessment	a3
Outlook	Stable

Source: Moody's Investors Service

Contacts

Xavier Lopez Del Rincon 44-20-7772-8652
VP – Senior Credit Officer
xavier.lopez-del-rincon@moodys.com

Andrew Blease 44-20-7772-5541
Associate Managing Director
andrew.blease@moodys.com

Avinor AS

Strong market position, State support and financial policy counterbalance exposure to weak carrier and oil industry

Avinor AS (Avinor) is a company that owns and operates a network of 46 airports in Norway, and is the sole provider of air navigation services within Norwegian airspace. As a fully state-owned multi-airport network with conservative financial policies, Avinor is well equipped to withstand traffic shocks.

» **Avinor's investment grade credit profile is underpinned by its strong market position.** Avinor AS is a network of 46 airports that capture more than 90% of traffic at Norwegian airports. Avinor's catchment area is characterised by a well developed economy, with very high GDP per capita.

» **Avinor is expected to be resilient in the event of its main carrier failing.** Although SAS AB, (rated B3) represents c. 40% of annual traffic volumes at Avinor, the company is expected to be resilient to a failure of SAS, given its structure as a multi-airport network with an origin and destination traffic profile.

» **Operation of a network of diverse airports mitigates risks from Norway's exposure to the oil industry.** As the oil and gas sector represents 22% of Norway's economy, recent falls in oil prices have had a negative impact on the economic fortunes of oil-dependent Stavanger and Bergen and by extension traffic at airports serving these cities. However, Avinor's operation of a national network of airports ensures a certain degree of geographic and economic diversification.

» **State ownership involves the operation of loss-making airports but highlights the strategic importance of the network.** The Avinor network includes a number of loss-making regional and local airports, which are operated to achieve social objectives set by the government and which are subsidised by the largest airports in the network. As a result, the company's airport division reports lower profitability than many of its European peers. We assess, however, the likelihood of extraordinary government support to Avinor as strong, given that it is fully owned by the Kingdom of Norway and considered by the government as strategically important to meet political objectives.

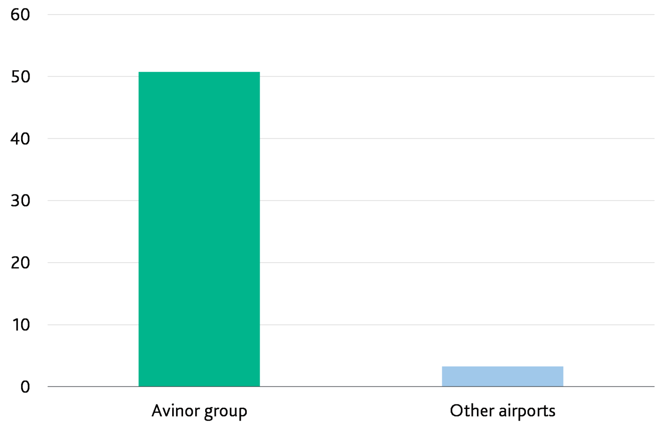
» **Conservative financial policies further mitigate traffic risks.** Although Avinor is undergoing significant expansionary investment, its financial policies have been designed to minimise additional indebtedness. Avinor's dividend policy includes hard caps and recycling of the proceeds from the sale of non-core assets. In addition, the company has the ability to postpone some of the projects, which are due to start in 2017 and beyond, to better align the increase in indebtedness and the company's cash generation.

Avinor's investment grade credit profile is underpinned by its strong market position

Avinor AS (Avinor) is a company that owns and operates a network of 46 airports in Norway, and is the sole provider of air navigation services within Norwegian airspace. Avinor benefits from a near monopoly position in Norway – a country with a total population of c. 5.2 million inhabitants - accounting for over 90% of Norwegian passenger traffic in 2015. Even though the Avinor network serves almost the entire needs of Norway, the relative small population of the country explains why Avinor receives a score of “Aa” rather than “Aaa” for the “Size of Service Area” subfactor, in our “Privately Managed Airports and Related Issuers” rating methodology.

Exhibit 1

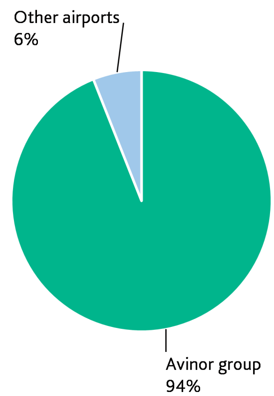
Passenger traffic at Norwegian airports in 2015 (million passengers)



Source: Avinor

Exhibit 2

Market shares of the Avinor group and other airports in Norway in 2015



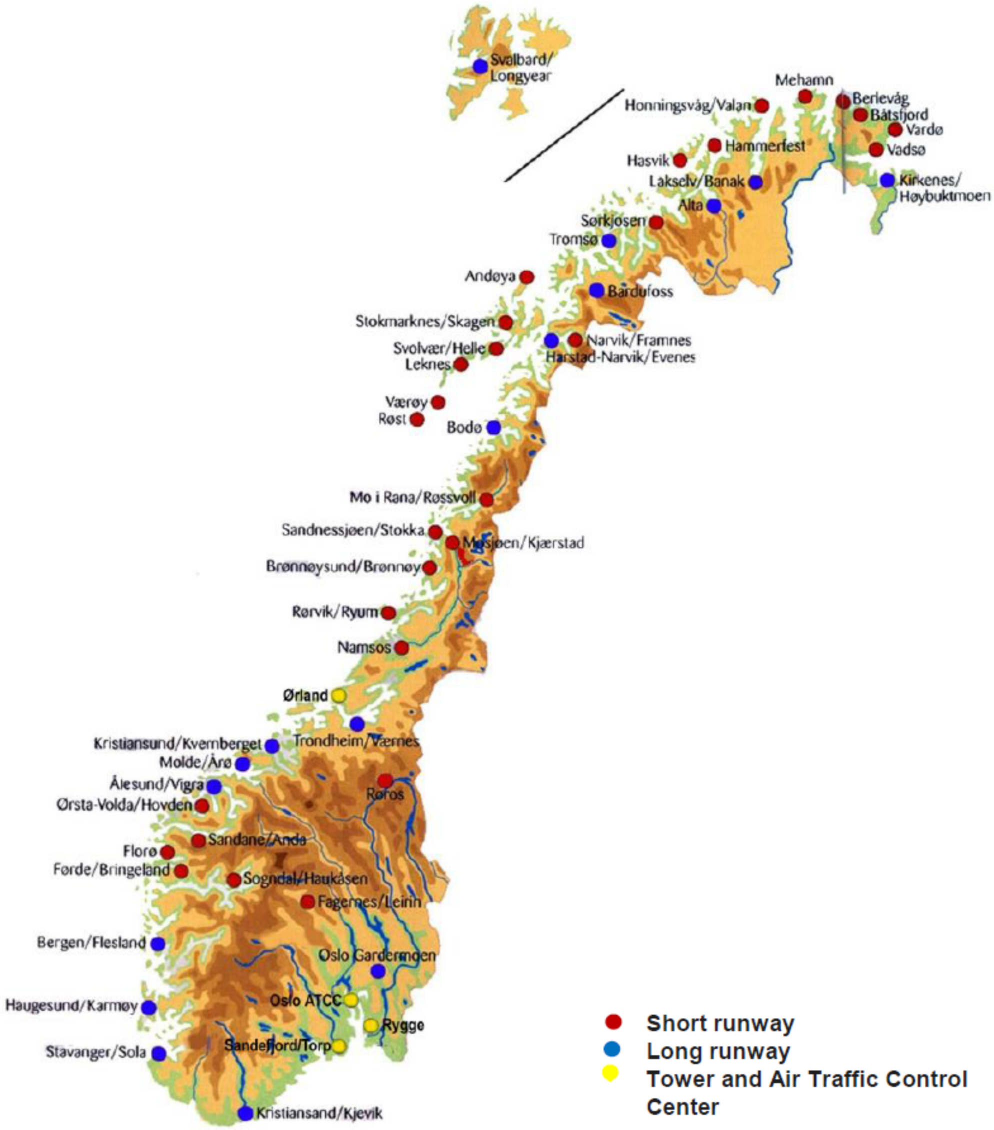
Source: Avinor

Air travel is an essential facilitator of domestic mobility given the patterns of population distribution and certain geographical features, such as topography and climate, that hinder surface transport. Thanks to the geographical reach of the Avinor network (see map below), 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.

Given this strong and entrenched competitive position, Avinor receives a score of “Aaa” for the “Competition for Travel” subfactor.

Exhibit 3

Location of Avinor airports in Norway

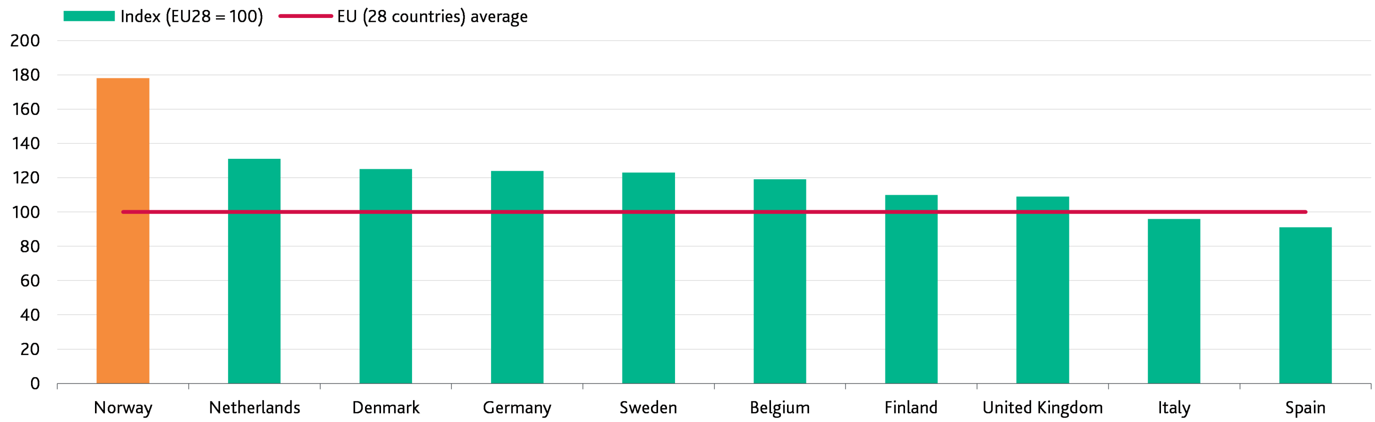


Source: Avinor

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. In fact, the country topped both tables in their latest edition.

Exhibit 4

GDP per capita in purchasing power standard in 2014 (index - EU28 = 100)



Source: Eurostat

Exhibit 5

Norway Human Development and Inequality-Adjusted Human Development Indices compared to Nordic peers

	UN HDI	Rank in 2014	UN Inequality adjusted HDI	Rank in 2014	Gini coefficient 2005-2013	Rank (among 142 countries)
Norway	0.9439	1	0.8932	1	26.83	8
Denmark	0.9233	4	0.8563	5	26.88	9
Sweden	0.9068	14	0.8464	11	26.08	3
Finland	0.8827	24	0.8339	14	27.79	11
OECD average	0.8801		0.7634			
World average	0.7105		0.5485			

Source: United Nations

Notwithstanding the high levels of income per capita and low levels of income inequality, Avinor receives a score of "Aa" for the "Economic Strength and Diversity of Service Area", rather than "Aaa" on account of Norway's exposure to the oil and gas sector, which represents 20% of Norway's GDP.

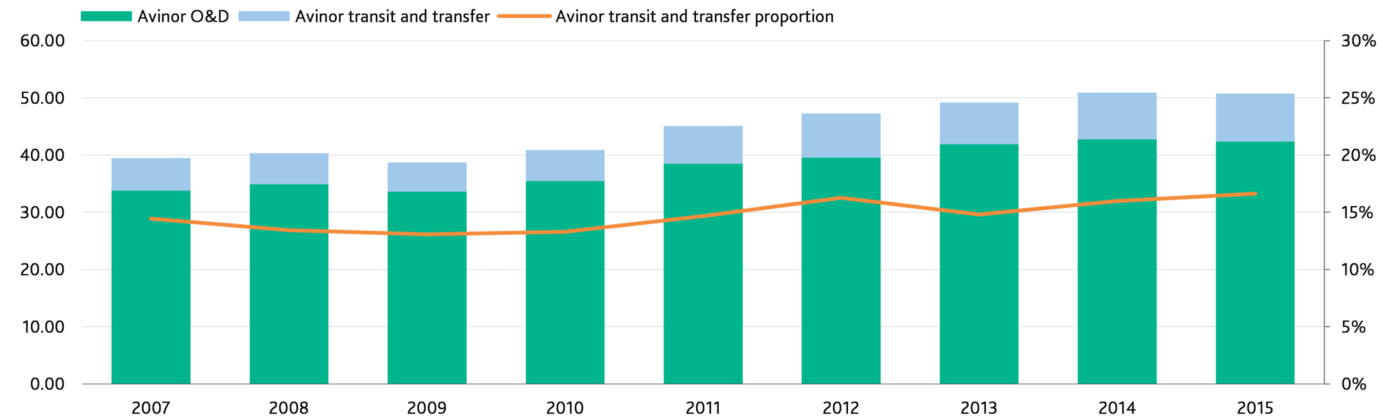
Avinor is expected to be resilient in the event of its main carrier failing

SAS AB, (rated B3 with a BCA of caa1) represents c. 40% of annual traffic volumes at Avinor and has similar market shares at Copenhagen airport and across the Swedavia network. In spite of significant restructuring efforts made over the recent past, the airline remains in a challenging position as it competes with growing low cost competitors and has recognised that it needs to further enhance its cost structure in order to compete successfully in the longer term. A significant retrenchment of operations or an outright failure of the airline would have impacts on traffic volumes and revenues at these airport groups.

Origin and destination traffic is more resilient than transfer traffic to airline failures, as it is much less reliant on the individual airline's route network. In the event of an airline failure, other airlines tend to pick up the traffic, as evidenced by the evolution of O&D and transfer traffic at Brussels airport following the bankruptcy of Sabena in 2001. Transfer and transit traffic, on the other hand, is more likely to be permanently lost if the airline using the airport as a hub ceases operations.

Exhibit 6

Evolution of O&D and transfer traffic at Avinor (million passengers, LHS; percentage over total passengers, RHS)

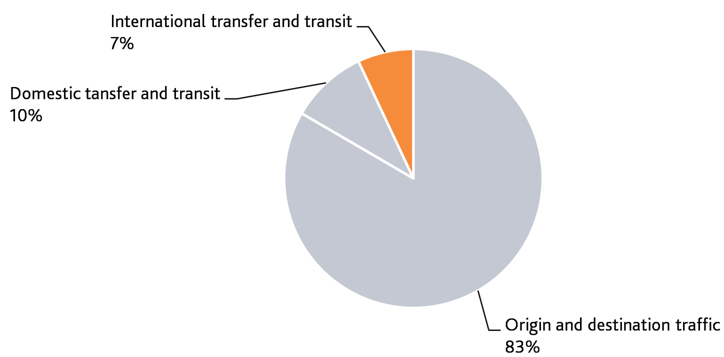


Source: Avinor

Total transfer and transit transfer at Avinor represents 17% of total traffic. However, 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%.

Exhibit 7

Proportion of traffic potentially at risk of permanent loss in case of major airline failure at Avinor



Source: Avinor

As a multi-airport network, with an origin and destination profile, Avinor's traffic is expected to be more resilient to a failure of SAS than a single-airport hub airport may be.

In our assessment of Avinor's carrier base, we take into account the different nature of the risks related to the exposure to SAS AB. Avinor receives a score of "A" given its origin and destination profile, the fact that its primary carrier accounts for 40% of total traffic and its fairly well diversified carrier base.

Operation of a network of diverse airports mitigates risks from Norway's exposure to the oil industry

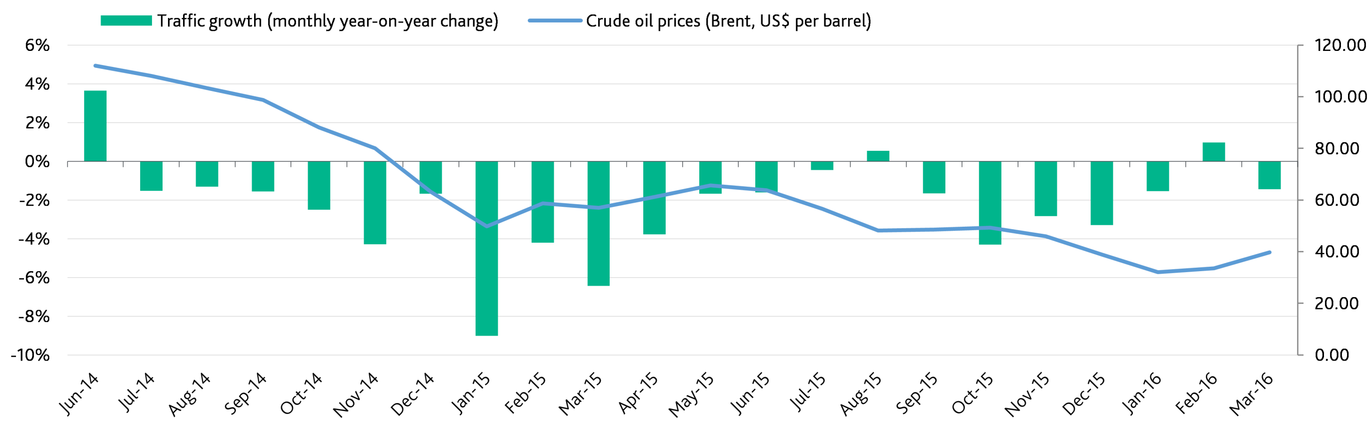
Even though Norway is one of the wealthiest countries in the world, the importance of the oil and gas industries, which taken together represent 22% of Norway's economy, exposes the country to potential economic pressures in times of low commodity prices. Lower economic activity can, in turn, have a negative impact on traffic at Avinor's airports.

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. By March 2016, crude oil prices were almost two-thirds lower than their average levels in June 2014. The anticipated fall in oil revenues for the country triggered a depreciation of the Norwegian Krone, which has lost 28% of its value against the Dollar and 14% against the Euro since September 2014. As the depreciation increases the cost of holidaying abroad, the demand for air travel has been impacted. In addition, unemployment also recently climbed to 4.6% of the workforce, a level that is modest by international standards but represents a 10-year high in Norway and can also curtail discretionary demand for travel.

The impact on traffic growth has been more pronounced at Bergen and Stavanger, two airports which capture c. 20% of total traffic on the Avinor network and which are located in cities particularly exposed to the oil and gas industries.

Exhibit 8

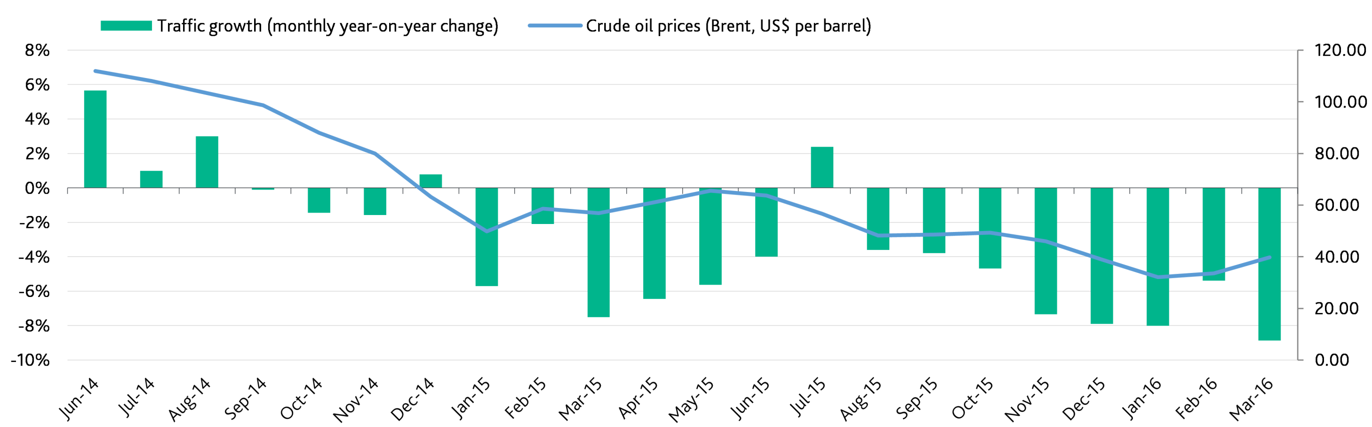
Evolution of crude oil prices (Brent, US$ per barrel, RHS) and traffic growth (monthly year-on-year change, LHS) at Bergen airport



Source: FactSet and Avinor

Exhibit 9

Evolution of crude oil prices (Brent, US$ per barrel, RHS) and traffic growth (monthly year-on-year change, LHS) at Stavanger airport

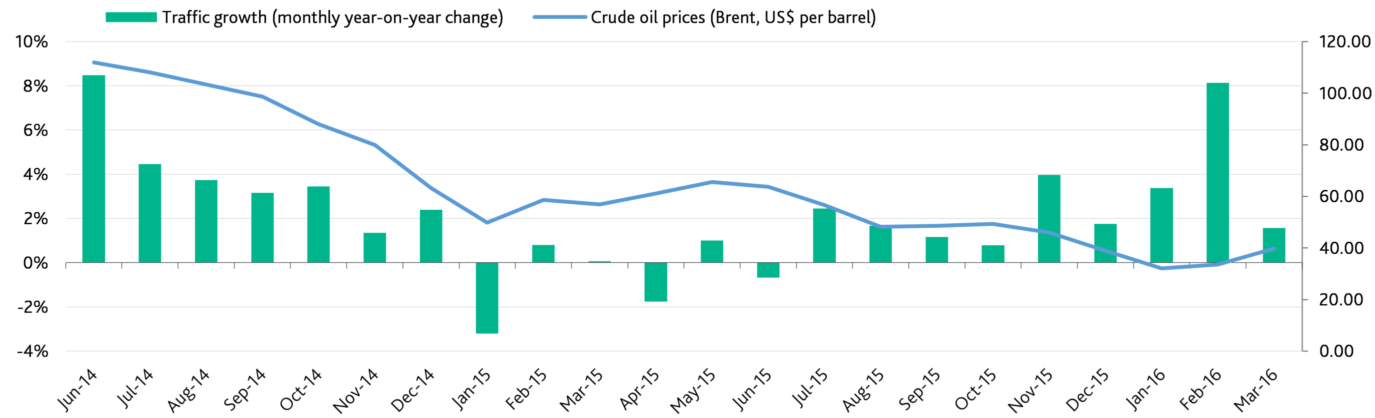


Source: FactSet and Avinor

However, the same analysis for the rest of the network (which represents c. 80% of total Avinor traffic) and for Oslo airport (which represents c. 50% of total Avinor traffic) shows that not all the airports in the network are as exposed to the fortunes of the oil and gas industries. The impact of lower oil prices at these airports has been less pronounced and concentrated over a shorter period of time, with airports returning to positive growth in the second half of 2015.

Exhibit 10

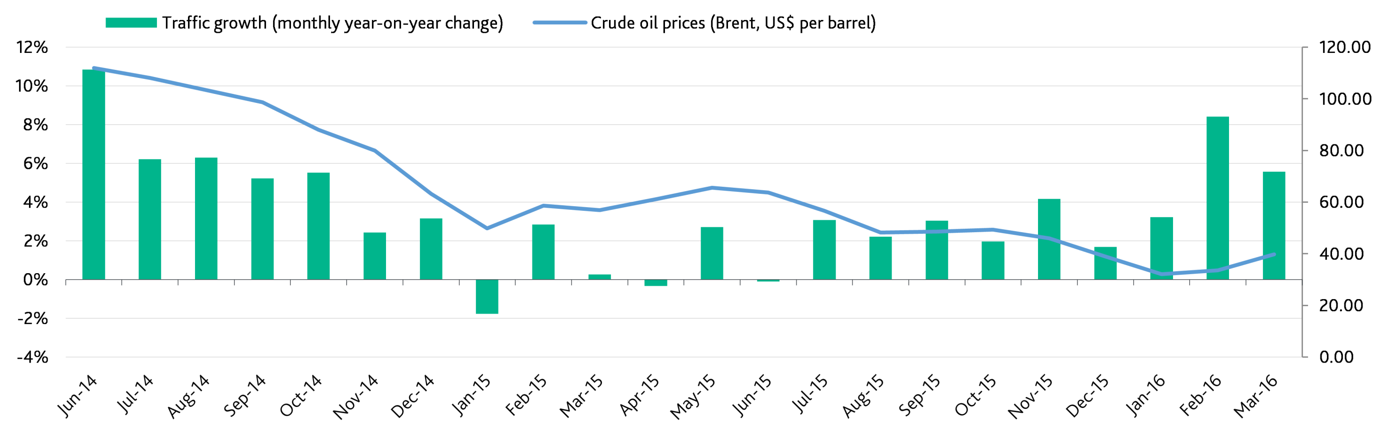
Evolution of crude oil prices (Brent, US$ per barrel, RHS) and traffic growth (monthly year-on-year change, LHS) at the Avinor network, excluding Bergen and Stavanger airports



Source: FactSet and Avinor

Exhibit 11

Evolution of crude oil prices (Brent, US$ per barrel, RHS) and traffic growth (monthly year-on-year change, LHS) at Oslo airport

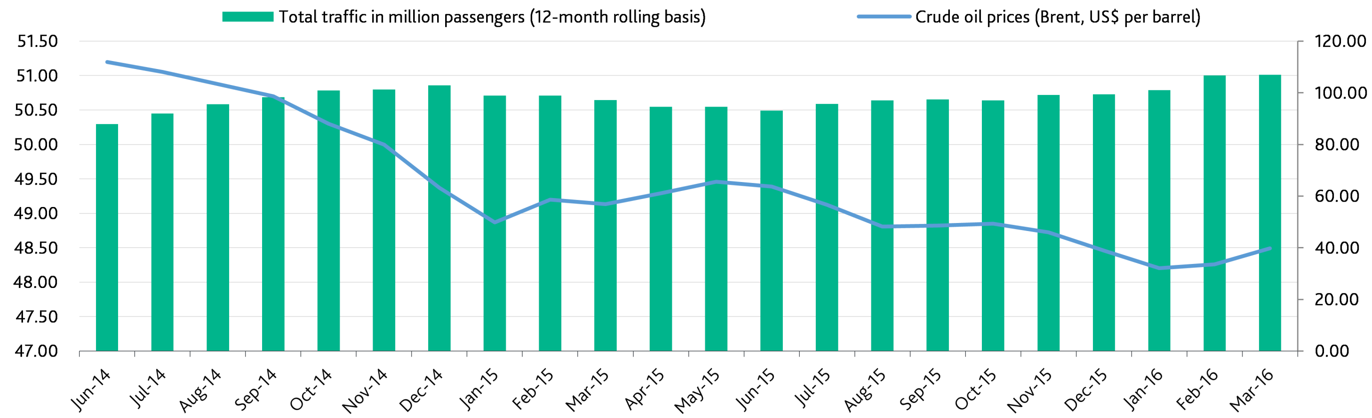


Source: FactSet and Avinor

The overall impact on traffic of the fall in crude oil prices has been mitigated by the diverse nature of the airports in the Avinor network. Whilst the network saw a modest traffic decline of 0.25% in 2015, the network returned to year on year growth in the second half of 2015, in spite of continuing downwards pressure on oil prices. As a result, traffic volumes on the Avinor network have recovered, recording all-time highs in March 2016 on a 12-month rolling basis.

Exhibit 12

Evolution of crude oil prices (Brent, US$ per barrel, RHS) and traffic volumes (million passengers, 12-month rolling basis, LHS) at the Avinor network



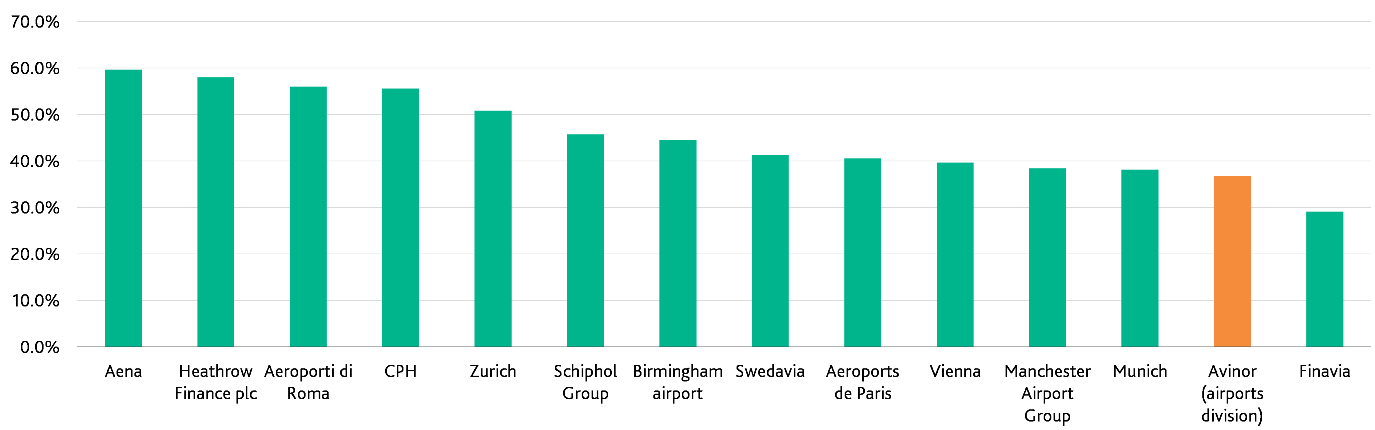
Source: FactSet and Avinor

State ownership involves the operation of loss-making airports but highlights the strategic importance of the network

Avinor is 100% owned by the Kingdom of Norway and considered by the government as strategically important to meet political objectives, for example facilitating mobility in rural and remote areas. Avinor is classified as a "category 4" company, the highest ranking an entity can receive in terms of its strategic importance to the Norwegian government. As owner, the government 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. As a result, Avinor reports EBITDA margins for its airports division that are lower than those of other European airport companies.

Exhibit 13

Reported EBITDA margins at various European airport companies

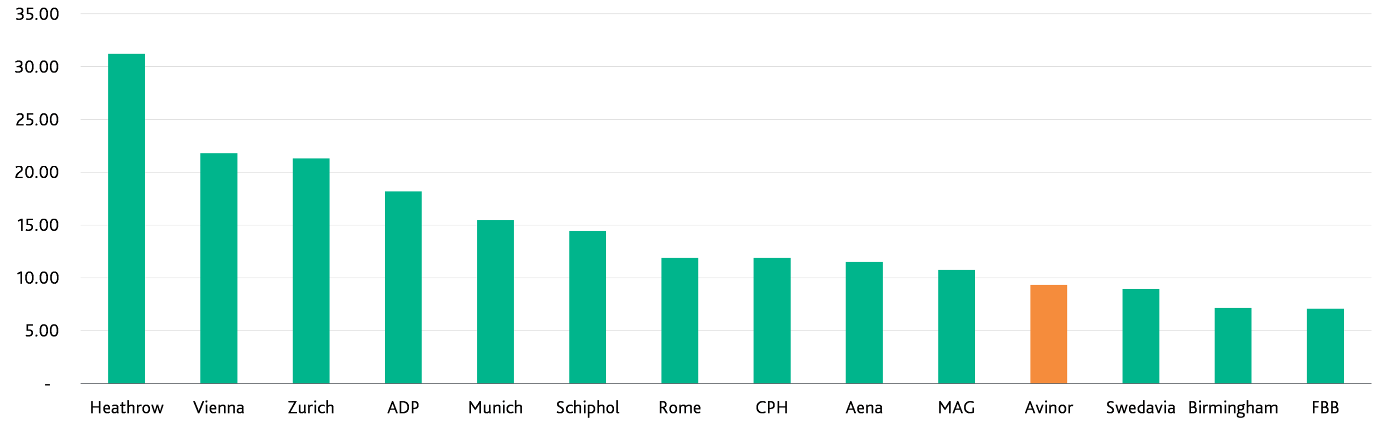


Note: CPH = Copenhagen Airports A/S
Source: latest available information from company sources

The lower profitability of Avinor airports is partly explained by lower airport tariffs on average than at European peers.

Exhibit 14

Aeronautical revenues per passenger (EUR / passenger) at various European airport companies

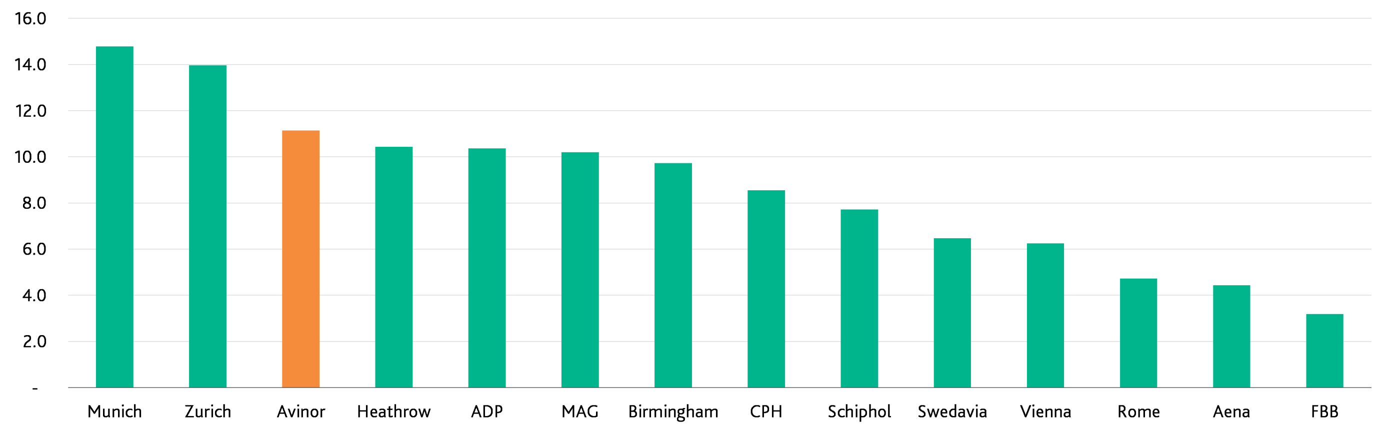


Note: ADP = Aeroports de Paris; CPH = Copenhagen Airports A/S; MAG = Manchester Airport Group; FBB = Flughafen Berlin Brandenburg
Source: latest available information from company sources

However, Avinor exhibits some of the highest commercial revenues per passengers amongst this peer group.

Exhibit 15

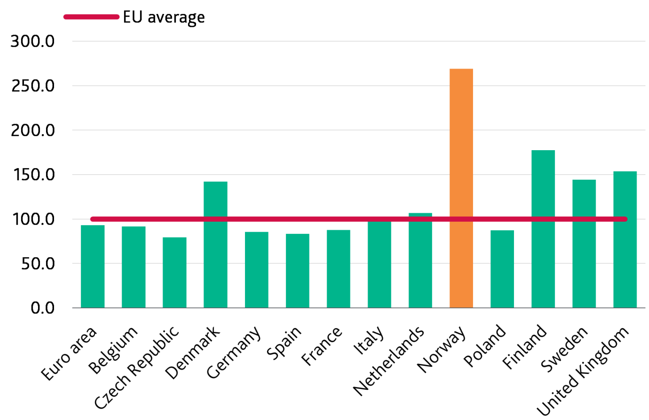
Commercial revenues per passenger (EUR / passenger) at various European airport companies



Note: ADP = Aeroports de Paris; MAG = Manchester Airport Group; CPH = Copenhagen Airports A/S; FBB = Flughafen Berlin Brandenburg
Source: latest available information from company sources

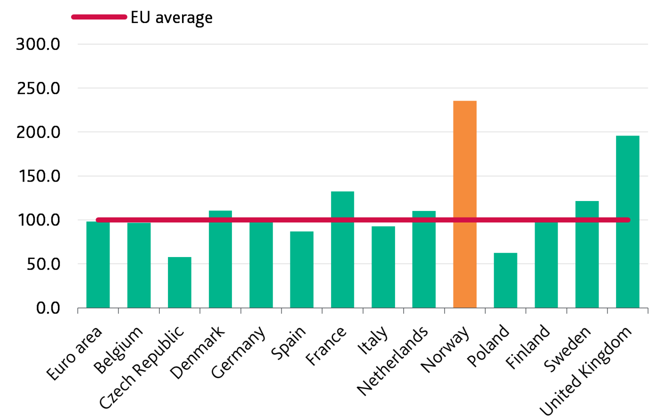
Avinor's higher than average commercial revenues are partly explained by the propensity of Norwegian residents to purchase duty-free alcohol and tobacco products at airports, given that these goods are much more heavily taxed in Norway. Tax rules in Norway allow passengers departing or arriving on international flights to purchase a certain quantity of alcohol and tobacco products without paying the taxes these products normally attract. The opportunity to purchase tax-free products on arrival is a key factor in boosting commercial revenues at Avinor, given that much of the international traffic in the Avinor network is outbound in origin and it may not be convenient for Norwegian residents to buy these products on departure.

Exhibit 16
Average prices of alcoholic beverages (inclusive of tax) in purchasing power standard in 2014 (index - EU28 = 100)



Source: Eurostat

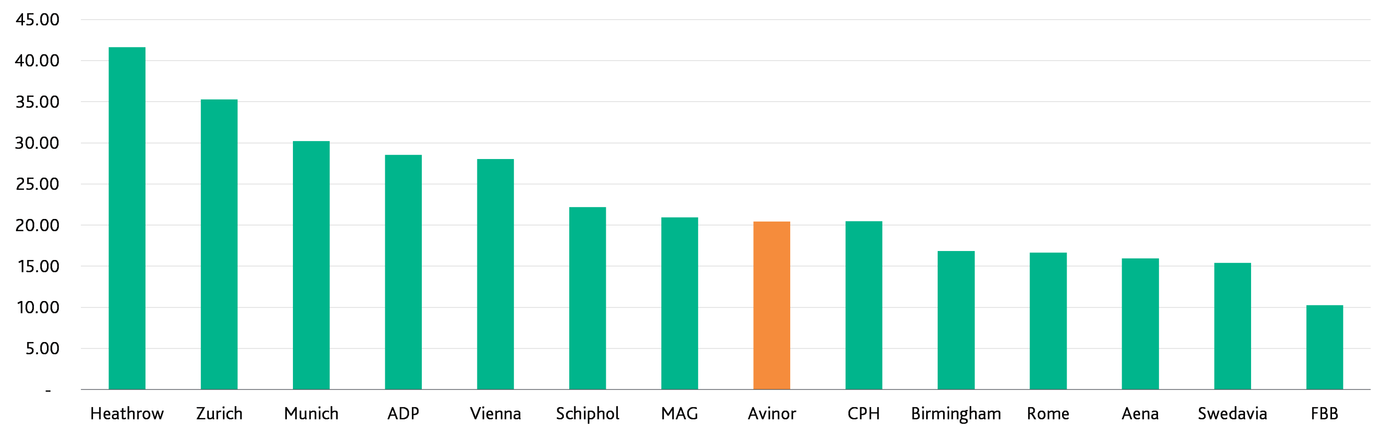
Exhibit 17
Average prices of tobacco products (inclusive of tax) in purchasing power standard in 2014 (index - EU28 = 100)



Source: Eurostat

Once we consider commercial revenues, Avinor's total revenues per passengers are higher than those at airports with higher reported profitability.

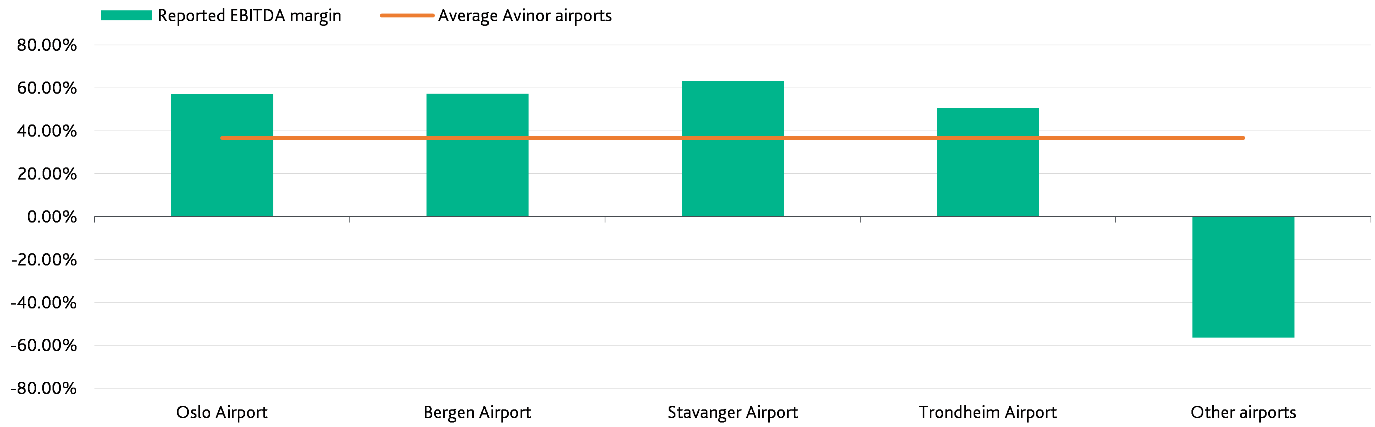
Exhibit 18
Total revenues per passenger (EUR / passenger) at various European airport companies



Note: ADP = Aeroports de Paris; MAG = Manchester Airport Group; CPH = Copenhagen Airports A/S; FBB = Flughafen Berlin Brandenburg
Source: latest available information from company sources

As total revenues per passenger are similar than at airports exhibiting higher EBITDA margins, Avinor's lower profitability is explained by a higher cost base. However, the lower efficiency levels at Avinor airports are not generalised across all airports in the network. In fact, a more granular analysis of the profitability of Avinor airports shows that the four largest airports (which together represent 78% 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.

Exhibit 19
Reported EBITDA margins at Avinor's four largest airports and the rest of the network in 2014



Source: Avinor

As this analysis shows, the Norwegian government is effectively using those large, profitable airports to subsidise the operation of small, unprofitable airports.

The government 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 a management team and a Board that comprise experienced commercial professionals rather than civil servants. Nonetheless, it maintains important links with the company through the setting of tariffs and long term objectives. As a result of the strategic importance of the company to the government, we assess the likelihood of extraordinary government support to Avinor, should it become necessary, as strong under our “Government-Related Issuers” rating methodology. Given the sovereign rating of the Kingdom of Norway (Aaa, stable), the final rating of Avinor incorporates two notches of uplift from its baseline credit assessment (BCA) of a3.

Avinor’s conservative financial policies further mitigate traffic risks

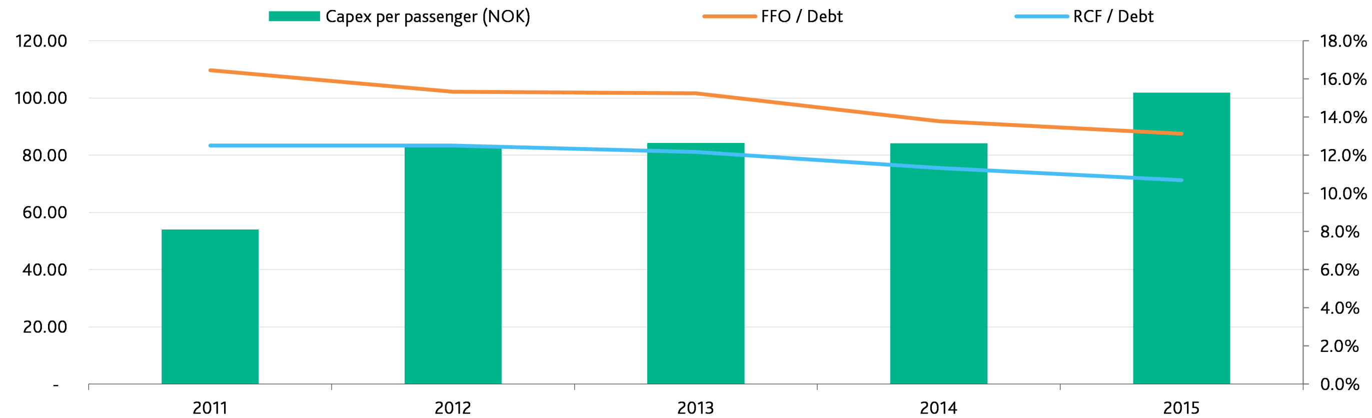
Over the last few years, Avinor’s leverage metrics have somewhat weakened as the company is undergoing a partly debt-funded expansionary investment programme.

As outlined in Norway’s Ten Year National Transportation Plan, Avinor intends to pursue an extensive capital programme during the period to 2023 with approximately NOK24.6 billion planned for the period 2015-20. The terminal 2 extension at Oslo airport is by far the most significant and challenging of the individual projects within Avinor's capital programme. The airport is said to be currently operating close to capacity and so expansion works are intended to create an additional 50% in passenger capacity. The works must take place within an operational airport environment, which creates additional complexity and a requirement for the works to be carefully phased. In addition, Avinor's is also undertaking a NOK4.2 billion terminal expansion project at Bergen airport, which will almost double the airport's terminal capacity by 2017. Both projects are on track to be delivered on time and within budget.

The company has, however, decided to pursue a prudent financial policy to minimise the impact on leverage of this expansionary investment programme. This conservative approach to financial policies 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 whilst investments are high (until 2018). As the company is selling non-core assets, such as hotel businesses located near some of Avinor’s airports, the cap on dividends means that the proceeds from these sales are being 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 during this period, in spite of the notable investment effort and the increased indebtedness.

Exhibit 20

Evolution of FFO / Debt, RCF / Debt (in percentage terms, RHS) and capital expenditure per passenger (NOK per passenger, LHS) at Avinor



Source: Avinor

In addition, as c. 50% of the 2015-2020 investment programme relates to uncommitted projects, which are due to start in 2017 and beyond, the company has scope to defer some of this expenditure should traffic be below expectations.

Given the prudent approach of the management, Avinor receives a score of “A” for the “Financial Policy” factor.

Appendix: Privately Managed Airports and Related Issuers Rating Methodology scores

Exhibit 21

Avinor AS - Rating Factors Grid

Privately Managed Airports and Related Issuers Industry Grid [1][2]	Latest Financial Year ended 31/12/2015		Moody's 12-18 Month Forward View As of 2/8/2016 [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	A	A	A	A
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)	4.7x	A	4x - 4.6x	Baa
b) FFO / Debt	13.1%	Baa	12% - 14%	Baa
c) Moody's Debt Service Coverage Ratio	4.1x	Baa	3.6x - 4x	Baa
d) RCF / Debt	10.7%	A	9% - 11%	A
Rating:				
Indicated Rating from Grid Factors 1-6		A2		A3
Rating Lift	0.0	0.0	0	0.0
a) Indicated Rating from Grid		A2		A3
b) Actual Baseline Credit Assessment Assigned				a3

Government-Related Issuer	Factor
a) Baseline Credit Assessment	a3
b) Government Local Currency Rating	Aaa, Stable
c) Default Dependence	Moderate
d) Support	Strong
e) Final Rating Outcome	A1, Stable

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 12/31/2014; Source: Moody's Financial Metrics.
[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.

Moody's Related Research

» Share of Investment-Grade Issuers in the Nordics To Stay Higher Than Rest of Europe

» European toll roads and airports: Traffic growth to offset weak tariff increases

» Non-Financial Corporates - Nordic Region: Bond Issuance to Fall Again in 2016

» Privately Managed Airports and Related Issuers

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

REPORT NUMBER 1027918

MOODY'S INVESTORS SERVICE