Research Update:

Avinor AS Outlook Revised To Stable On Recovering Air Traffic And Financial Performance; 'A/A-1' Ratings Affirmed

October 11, 2023

Rating Action Overview

- The ongoing solid air traffic recovery toward pre-pandemic levels of 54 million passengers by 2025 should continue to lift earnings and cash flow for Avinor AS' airport network.
- Based on our traffic estimates and given Avinor's proposal to increase aeronautical charges by 15% in 2024, the ratio of funds from operations (FFO) to debt for the airport network should reach 10% or above over the next few years, despite the risks of additional leverage to finance investments ahead.
- We therefore revised our outlook to stable from negative and affirmed our 'A/A-1' long- and short-term issuer credit ratings on Avinor.
- The stable outlook on the ratings indicates that traffic recovery will continue and Avinor will effectively manage its operating and capital expenditure (capex), such that FFO to debt will remain about 10% over the next few years.

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Rating Action Rationale

We anticipate passenger numbers will range between 48.5 million and 50.0 million in 2023, with a gradual and sustainable recovery in the next few years, potentially reaching the pre-pandemic level of 54.0 million passengers by 2025. Avinor's passenger recovery path in 2023 has so far been in line with other regional airports in Europe, stemming mainly from holiday and leisure passengers, while business travel remains below pre-pandemic volumes. The 2023 summer holiday season was strong for the network and made the largest contribution to the company's performance so far this year.

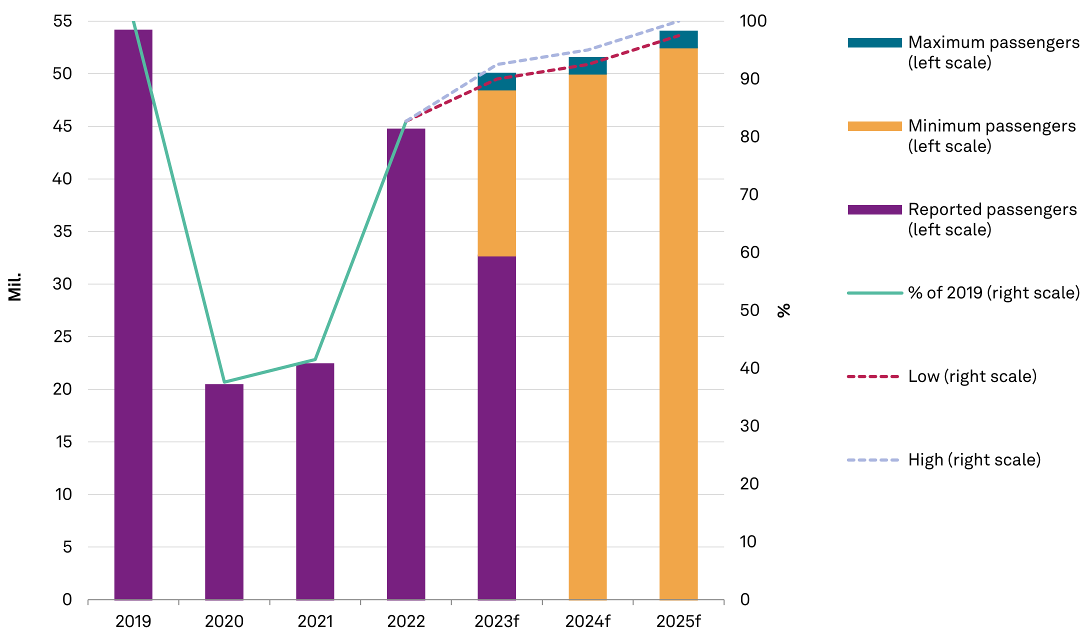
Despite the positive passenger growth prospects, the following factors could prevent the airport group from reaching 2019 passenger levels earlier than 2025:

- The overall tough macroeconomic environment and affordability concerns may affect passengers' travel decisions and slow down the recovery trajectory; and

- Major airline counterparties SAS and Norwegian currently have a weak credit profile, which could result in reduced capacity deployment, albeit partially compensated by new entrants such as Transavia Airlines and Croatia Airlines Ltd.

Chart 1

Passenger numbers at Avinor's airports could reach pre-pandemic levels by 2025
Annual passengers (mil); compared with 2019 (%)



f--Forecast. Source: S&P Global Ratings.

Avinor's proposed tariff increase of 15% for 2024, if accepted by the government, will be positive for the company's future cash flow, but is not sufficient to solve the group's return imbalances. This is because since the pandemic, the company has not increased aviation charges sufficiently to ensure a fair return on its regulated asset base (RAB). We understand that Avinor has a gap of Norwegian krone (NOK) 1.6 billion between its current EBITDA and the level it would need to meet the regulatory return. To rebalance this equation, the aeronautical charges per passenger would have to increase by more than 60%. Our forecasts assume the company will adjust tariffs by 15%, which will allow it to recover about NOK500 million of the current EBITDA gap, meaning it is uncertain whether the government will consider future forms of compensation to support investments.

Without further rate hikes, we forecast Avinor's cash flow generation will not be sufficient to manage its NOK12.5 billion investment plan until 2025. According to our forecast, the company will need to raise NOK1.5 billion annually to support the financing of its large investment plan. This will restrict any deleveraging prospects if not properly compensated and will likely delay any potential rating upside.

Avinor has been working on the construction of Mo I Rana and Bodo airports, which are expected to be fully operational by 2027 and 2029, respectively. These investments are part of the Norwegian government's goal to increase the country's connectivity by air, given its complex geography and topography, so that building new airports is the easiest--and cheapest--way to connect remote areas. The company is also planning to complete other deferred investment projects that were postponed during the pandemic.

Nevertheless, we think Avinor will be able to sustain credit metrics commensurate with its current ratings. We forecast that the company will reach and sustain FFO to debt of 10% thanks to the continued increase in passengers and airport charges. We also take into account the management's plan to maintain costs and operating expenses control, and its prudent financial policy which will delay dividends.

We continue to view a very high likelihood of extraordinary support from the Norwegian government to Avinor. We view Norway's government as supportive toward state-owned enterprises, based on the recent track record. This was demonstrated during the pandemic, when Avinor received NOK7.4 billion from the government to compensate for lost revenue so the airport could continue with its operations. Avinor operates 43 out of the 47 airports in Norway, including both profitable and nonprofitable assets. It is 100% owned by the government of Norway, which has not demonstrated any willingness to privatize the company or its related businesses, such as the air navigation services that had been targeted for potential privatization in the past. As a result, we incorporate a four-notch uplift from the 'bbb-' stand-alone credit profile (SACP) to Avinor's 'A' rating.

Outlook

The stable outlook on the long-term issuer credit rating reflects our expectation that FFO to debt will remain commensurate for the current rating level at 10% as passenger volumes recover throughout the airport network and tariffs are adjusted by 15% in 2024.

Downside scenario

We could lower the long-term ratings on Avinor by one notch if, in our view, the company is not able to sustain FFO to debt above 8% in the next years. This could occur if:

- Avinor's profitability levels decrease, either because of higher costs from the current high inflationary environment, or aeronautical tariffs not being adjusted to properly incorporate inflationary pressures and the remuneration on investments;
- The company needs to issue further debt beyond our expectations, either for additional investments or funding its operations; or
- The Norwegian government's stance unexpectedly becomes inconsistent with a very high likelihood of support. This could stem from a change in the government's overall plan for extraordinary state aid if an unexpected privatization or a revocation of the company's mandate to provide air navigation services is announced.

Upside scenario

We could upgrade Avinor's long-term ratings by one notch if the company were able to sustain FFO to debt consistently above 10%. This could be achieved if:

- Avinor's aeronautical tariffs were periodically adjusted above inflation in the next years, because of a balanced financial framework, increasing its profitability levels so that it can recover the gap between the ideal tariff needed to remunerate the investments and the current tariff; and
- The company were able to manage its costs, investments, and operations without distributing dividends in the next few years, so that it reduced the debt burden to fund expansion investments.

Company Description

Avinor AS owns and operates 43 of the 47 airports in Norway, in addition to three air traffic control centers and one remote control center in the country. The airport network includes Norway's main airport in Oslo, which accounts for more than 70% of the country's international traffic. During the first eight months of 2023, 32.7 million passengers used the airports from Avinor, equivalent to 90% of 2019 levels. Avinor is 100% owned by the Norwegian government, which is in turn represented by the Ministry of Transport.

In the rolling 12 months that ended on June 30, 2023, Avinor's total revenue was NOK11.3 billion, 17.6% higher than in the same period of 2022, and S&P Global Ratings-adjusted EBITDA amounted to NOK3.5 billion, 22.6% higher than in June 2022. The revenue base comprises aeronautical revenue (about 50%), charged to airlines primarily for passenger facilities, take-off and landing, and aircraft parking. Under a single-till regulatory mechanism, revenue is subsidized by nonaeronautical income generated from retail, car parking, and property rental.

Our Base-Case Scenario

Our base-case assumptions for 2023-2025 are as follows:

Assumptions

- Passenger volumes will continue growing in the coming years, although at a slower pace, given that 2023 operations have shown signs that travel is approaching a new normal standard, and because of disposable income challenges that may prevent people from travelling.
- An increase of aeronautical charges of 15% in 2024, resulting in NOK110 per passenger. From 2025, the charges are adjusted by the Norwegian consumer price index (CPI) of 3.2% in 2025.
- We are not factoring additional government support considering passenger levels have already reached 90% of 2019 levels.
- We expect the spend per person will be about NOK115-NOK120 in 2023 and will remain at this level in real terms.
- Average EBITDA margins of 30%-32.5% in 2023, 32.5%-35% in 2024, and 35%-37.5% in 2025 thanks to a combination of cost savings, gradual passenger volume increase, and higher

aeronautical charges.

- We forecast annual investments between NOK3.5 billion-NOK4.0 billion in 2023, and NOK4.0 billion-NOK4.5 billion annually in 2024 and 2025.
- Annual additional debt of NOK1.5 billion to finance investments.
- We do not expect dividend distributions to the Norwegian government in the following years, given that the company will need to issue additional debt to fund the investment plan.

Key metrics

Avinor AS--Key metrics

	--Fiscal year ended Dec. 31--				
Bil. NOK	**2019a**	**2022a**	**2023e**	**2024e**	**2025e**
Passengers (million)	54.1	44.7	48.5-50.0	50.0-51.5	52.5-54.0
Passengers (% of 2019 levels)	100	82.7	90.0-92.5	92.5-95.0	97.5-100.0
Aeronautical tariff (NOK per passenger)	99.4	110.6	110-115	120-125	125-130
Revenue	11.8	10.4	11.0-11.2	11.8-12.0	12.6-12.8
EBITDA	4.6	3.1	3.3-3.5	3.8-4.0	4.4-4.6
EBITDA margin (%)	38.9	29.9	30.0-32.5	32.5-35.0	35.0-37.5
Capital expenditure	2.5	3.1	3.5-4.0	4.0-4.5	4.0-4.5
FOCF	0.9	(0.9)	(1.8)-(1.6)	(1.9)-(1.7)	(1.6)-(1.4)
Dividends	0.6	--	--	--	--
FFO to debt (%)	15.1	9.8	9.0-10.0	9.5-10.5	11.0-12.0
FOCF to debt (%)	3.6	(3.5)	(7.5)-(5.0)	(7.5)-(5.0)	(5.0)-(2.5)

a--Actual. e--Estimate. f--Forecast. FOCF--Free operating cash flow. FFO--Funds from operations. NOK--Norwegian krone.

Liquidity

We view Avinor's liquidity as adequate. We estimate the group's liquidity sources will exceed uses by at least 1.2x in the upcoming 12 months. Liquidity sources will continue to exceed uses even if EBITDA were to decline by 15%.

We think the NOK1.8 billion debt maturities are manageable, but the company should refinance at least part of its NOK3.5 billion maturities coming due in the next 24 months. Avinor has access to the capital markets and well-established, solid relationships with banks, so we do not expect this to result in a high refinancing risk to the company. Additionally, the company has flexibility to defer investments, especially those related to the airport network's expansion.

Principal liquidity sources over the 12 months from June 30, 2023 include:

- Available cash and cash equivalents of NOK891.6 million;
- A fully available NOK4.3 billion committed credit facility, out of which NOK300 million is due in April 2026 and NOK4.0 billion is due in June 2026; and
- Estimated cash FFO of about NOK2.7 billion.

Principal uses of liquidity in that period include:

- Debt maturities of about NOK1.7 billion;
- Investments, mostly focused on maintenance, of about NOK2.0 billion; and
- No dividend distribution.

Covenants

Avinor has to comply with the following maintenance covenant:

- Equity to equity-plus-interest-bearing-debt ratio of at least 30%.

This covenant is specified on the loan agreements that Avinor have with the European Investment Bank, the Nordic Investment Bank, and on its unused credit facilities. As of June 30, 2023, Avinor complied with this covenant, as this ratio was 38.1%. In addition, Avinor has a change of control clause if the Ministry of Transport does not retain 100% ownership at any time.

Government Influence

We consider Avinor a government-related entity, and our view of a very high likelihood of government support is based on our assessment of Avinor's:

- Very important role to the government, as the operator of nearly all of Norway's airports and the sole provider of air navigation services for both civilian and military flights within Norwegian airspace. Because of Norway's unique topography and geography, combined with its high dependency on foreign trade, we consider that the integrated airport system constitutes essential infrastructure for the country to meet its key economic, social, and political objectives.
- Very strong link with the Norwegian government, based on the state's 100% ownership, the government's role in appointing Avinor's board members, its close oversight of the group's strategies, and its track record of financial support.

Environmental, Social, And Governance

Social factors are still a moderately negative consideration in our credit rating analysis of Avinor. As of August 2023, passenger volumes at the airports Avinor operates reached 32.7 million, which is equivalent to 90% of 2019 levels, mostly stemming from leisure travel, while the business clients are still taking longer to come back.

The company's exposure to airline carriers that are facing financial difficulties--Norwegian and SAS--especially for domestic demand that represents about 60% of the passengers, could result in capacity deployment at a slower pace at the airports. In our view, that could delay the demand recovery when compared with other European peers, especially if any carrier goes out of the market and needs to be replaced.

Although Avinor benefited from direct and substantial financial support during the pandemic from its shareholder, the Norwegian government--NOK3.6 billion in 2020 and NOK3.75 billion in 2021, which combined represent 60%-70% of 2019 revenue--we do not expect further financial support. As demand recovers, Avinor will have to rely on the commercial revenue and aeronautical charges to sustain its single-till regime.

Issue Ratings - Subordination Risk Analysis

Capital structure

Avinor's capital structure comprises senior unsecured debt issued at the parent level. As of June 30, 2023, the group's S&P Global Ratings-adjusted debt was of NOK26.7 billion, which includes pension liabilities as well. From the financial debt of NOK24.1 billion, about 75% comprises bonds that are listed on the Oslo and Luxembourg Stock Exchanges.

Analytical conclusions

We rate Avinor's debt 'A', the same as the issuer credit rating, because there is no significant element of subordination risk present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating	A/Stable/A-1
Business risk:	Strong
Country risk	Very low
Industry risk	Low
Competitive position	Strong
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bbb
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bbb-
Related government rating	AAA/Stable/A-1+
Likelihood of government support	Very high (+4 nothces)

Related Criteria

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

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

- Industry Top Trends Update Europe: Transportation Infrastructure, July 18, 2023
- European Air Travel Defies Economic Pressures On Robust Demand, June 7, 2023
- Tear Sheet: Avinor AS, Jan. 23, 2023

Ratings List

Outlook Action; Ratings Affirmed

	To	From
Avinor AS		
Issuer Credit Rating	A/Stable/A-1	A/Negative/A-1
Senior Unsecured	A	A