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Research Update:

Norway-Based Avinor AS Outlook Revised To Negative On Delayed Passenger Recovery; Ratings Affirmed At 'AA-/A-1+'

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Table Of Contents

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Overview

- We expect lower than previously forecast earnings in 2016 and 2017 for Norway-based airport network operator and air navigation services provider Avinor AS, mainly triggered by a delay in passenger recovery.
- Combined with the continuation of accelerated capital spending (capex) into 2016-2017, weaker-than-expected earnings will likely lead to credit measures which fall short of our guidelines for the current ratings.
- We are consequently revising our outlook on Avinor to negative from stable and affirming our 'AA-/A-1+' long- and short-term corporate credit ratings on the company.
- The negative outlook indicates that we may lower the ratings over the next 18 months if Avinor is unable to steadily expand its EBITDA and maintain credit measures commensurate with the current 'bbb+' stand-alone credit profile (SACP), given the company's significant and partly debt-funded expansionary capex.

Rating Action

On Sept. 22, 2016, S&P Global Ratings revised its outlook on Norway-based airport network operator and air navigation services provider Avinor AS to negative from stable.

We also affirmed our 'AA-/A-1+' long- and short-term corporate credit ratings on the company and our 'AA-' issue rating on the company's unsecured debt.

Rationale

The negative outlook reflects our view that continuously sluggish economic activity in Norway and constrained growth in passenger and commercial revenues might continue to weigh on Avinor's earnings in the short-to-medium term. Combined with accelerated capex to expand and upgrade the airport's infrastructure, we expect financial leverage to remain elevated through 2016 and 2017, with limited leeway in the company's credit metrics at the current rating level before a potential, but rather uncertain, recovery in 2018.

Under our base-case scenario, we forecast that Avinor's ratio performance will be weak for the rating in 2016 and 2017. However, we anticipate that the company will be able to improve credit metrics from 2018 onward and, therefore, sustain the 2015-2017 weighted-average ratio of funds from operations (FFO) to debt at 13%, which we consider to be commensurate with its current financial risk profile. However, we see a risk that the company may perform below our expectations, most notably if passenger volumes do not rebound to high-single-digit growth rates and commercial operations fail to expand at high-single-digit rates by 2018, resulting in credit measures falling sustainably short of our rating guidelines.

Over the past two years, Avinor's credits metrics weakened gradually because the pace of EBITDA expansion did not keep up with the pace of increasing debt resulting from high expansionary capital investments. This resulted in FFO to debt of about 13.7% in 2015, which compares with 14.4% in 2014. Most recently, however, the company's operating performance has been affected by weaker-than-expected passenger volumes with negative annual growth of -0.2% in 2015 and the resulting lower expansion of commercial revenue. We believe that there is a risk that these factors will continue to hamper Avinor's performance in the medium term--in particular, due to Norway's still weak economy following the collapse in oil prices and the recently introduced Norwegian aviation tax that is expected to negatively affect passenger volumes.

To address some of these challenges, the company's management runs a cost efficiency program which has already started proving beneficial. Furthermore, we forecast that from 2017 onward, once the currently under-construction terminals in Oslo and Bergen are operational, Avinor's EBITDA should benefit from reduced operating costs related to maintaining uninterrupted operations during the development of new terminals.

Our business risk assessment on Avinor reflects its strong competitive position due to its near-monopoly position as an integrated airport network operator in a wealthy country, and its status as the sole air traffic controller over Norwegian airspace, which implies a much larger scope of operations than other rated European airports. Furthermore, Avinor benefits from a high (about 85%) share of origin and destination traffic, which we consider to be generally less susceptible to passenger choice and airline performance than transfer traffic.

Our assessment also reflects Avinor's fairly resilient S&P Global Ratings-adjusted EBITDA margins, which we forecast will range between 33% and 38% in 2016-2018. We consider the group's profitability to be underpinned by a solid operating performance in the large airports--such as Oslo Gardermoen which accounts for about two-thirds of the group's earnings and generates EBITDA margins among the highest of European airports we rate--and expanding commercial activities. We also consider that Avinor has a history of managing operating costs well. However, we believe that the group's consolidated profitability will continue to be constrained by its loss-making local and regional airports--which operate as part of Avinor's public service obligation--and a limited ability to dispose of unprofitable operations. Nevertheless, we believe that the operation of unprofitable airports, without state subsidies, strengthens Avinor's importance to the government.

Our assessment of Avinor's financial risk profile is based on:

- Avinor's ample operating cash flows due to its protected market position and high EBITDA-to-operating cash flow conversion rate.
- Our expectation of increasing financial leverage and deteriorating credit measures, due to the accelerated and partly debt-funded capital investments to expand and enhance the airports' infrastructure.
- Some flexibility and discretion over the magnitude and timing of uncommitted capex.

Our base-case scenario assumes:

- Real GDP growth in Norway of 0.3% in 2016, 1.2% in 2017, and 1.6% in 2018.
- Annual passenger volume growth of 1.0%-2.0% in 2016, followed by a dip of (0.5)%–(1.0)% in 2017, and a recovery of 2.5%–3.5% in 2018. We typically see a relationship between GDP growth rates and passenger numbers at the airport and their retail spending.
- Revenues rising at a higher pace than traffic in 2017-2018 because of steadily improving and expanding commercial operations, and average tariffs increasing broadly in line with the consumer price index of Norway.
- Average adjusted EBITDA margin of about 33%-38% in 2016-2018 thanks to a demonstrated grip on cost control and gradually declining operating costs related to maintaining uninterrupted operations during the development of T3 Oslo Airport. The margin expansion is expected to be further accelerated by the increase of better margin commercial sales following the openings of new terminals in Oslo and Bergen.
- Acceleration in annual capex to Norwegian krone (NOK) 4.0 billion-NOK5.0 billion in 2016, followed by an average NOK3.0 billion-NOK4.0 billion in 2016-2017.
- Distribution of dividends at a constant payout ratio of 50% but not more than NOK500 million annually until 2018.

In accordance with our criteria for government-related entities, our view of a very high likelihood of government support is based on our assessment of Avinor's:

- Very important role 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. Due to Norway's unique topography and geography, combined with its high dependency on foreign trade, we believe 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. We do not expect Avinor to be privatized in the next 24 months.

Liquidity

The short-term rating on Avinor is 'A-1+'. We consider the group's liquidity to be strong. Avinor's liquidity profile is supported by its liquidity sources on hand (such as the undrawn long-term revolving credit facility [RCF] and available cash holding), its ability to generate solid operating cash flows, and its demonstrated access to capital markets. These sources compare favorably with liquidity uses, in particular mandatory debt repayments and high capex.

Our base-case liquidity assessment as of June 30, 2016, for the following 12 months, reflects the following factors and assumptions:

- We expect the group's liquidity sources will exceed liquidity uses by at least 1.5x in the next 12 months. Even when measured over the next 24 months, the ratio remains above 1.0x.
- Liquidity sources will continue to exceed uses, even if EBITDA declines by 30%.
- We understand that Avinor is in compliance with its financial covenant and we expect the group to be able to manage the covenant tests. The group's loan documentation includes one maintenance covenant; a ratio of equity to equity plus interest bearing debt of 30%. As of year-end 2015, Avinor's equity ratio was about 47%, which implies sufficient headroom.
- The group appears to have well-established, solid relationships with banks and a generally high standing in credit markets. Furthermore, Avinor has demonstrated uninterrupted access to commercial paper- and loan markets.
- Avinor has the likely ability to absorb high-impact, low-probability events without refinancing given its capability to reduce capex or increase tariffs in times of stress.

Principal sources of liquidity over the next 12 months as of June 30, 2016, include:

- Available cash and cash equivalents of about NOK1.44 billion;
- A fully available NOK4 billion RCF due in June 2019;
- A fully available NOK800 million RCF due November 2017; and
- Forecast operating cash flows of about NOK2.6 billion.

Principal uses of liquidity over the same period include:

- Short-term debt of about NOK1.55 billion;
- Expansionary (and to some extent discretionary) and maintenance capex of approximately NOK4.0 billion; and
- Discretionary dividends of NOK500 million.

Outlook

The negative outlook indicates that we may lower the ratings over the next 18 months if Avinor is unable to steadily expand its EBITDA margin and maintain credit measures commensurate with the current ratings, given the company's significant and partly debt-funded expansionary capex. At the current rating levels, we expect Avinor will be able to achieve a weighted-average ratio of adjusted FFO to debt of about 13%.

Downside scenario

We could lower the ratings if Avinor's EBITDA and leverage materially deviates from our base case over the next 12-18 months, resulting in a weighted-average FFO to debt falling below 13%. This is likely to happen if Avinor's sizable expansionary investments and airport infrastructure enhancements are not sufficiently mitigated, for example, if passenger volumes fail to sustainably recover from the second half of 2017 onward. This would also likely lead to underperformance in the commercial business.

We could also lower the ratings if the Norwegian government's stance became unexpectedly inconsistent with a very high likelihood of support. We believe this could stem from, among other factors, an unexpected privatization or a revocation of Avinor's mandate to provide air navigation services.

A negative rating action might also be triggered if the group's profitability deteriorated (such that the EBITDA margin fell sustainably below 30%), leading to a lower business risk profile assessment.

Upside scenario

We could revise the outlook back to stable if, from 2017 onward, Avinor's financial performance appeared to be strengthening. This would most likely occur thanks to a combination of increasing operating cash flow, robust and expanding passenger volumes and retail business, and gradually declining debt once capital investments slow, leading to a ratio of adjusted FFO to debt of well above 13% on a sustainable basis. We believe the group is unlikely to achieve this in the next 18-24 months.

Ratings Score Snapshot

Corporate Credit Rating: AA-/Negative/A-1+

Business risk: Strong
- Country risk: Very low
- Industry risk: Low
- Competitive position: Strong

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bbb+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)

- Liquidity: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb+
- Likelihood of government support: Very high (+4 notches from SACP)

Related Criteria And Research

Related Criteria

- 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
- Criteria - Corporates - Industrials: Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Avinor AS		
Corporate Credit Rating	AA-/Negative/A-1+	AA-/Stable/A-1+
Senior Unsecured	AA-	

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.