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Research Update:

Avinor AS Outlook Revised To Stable On Steady Performance And Postponed Subsidiary Demerger; Ratings Affirmed

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Table Of Contents

Research Update:

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Overview

- We forecast that Avinor will maintain strong operational performance, following 4.3% passenger growth in 2017, with weighted-average adjusted funds from operations (FFO) to debt of 14%-15% over 2018-2020 despite high capital expenditure needs and uncertainties around disputes with Norwegian armed forces, as well as potential pension changes.
- We also understand that the Norwegian government hasn't yet decided on the timing or process surrounding the demerger of the ANS subsidiary, Avinor Flysikrings AS, so our view of a very high likelihood that the government will provide extraordinary support to Avinor is unchanged.
- Earlier this year, International Airline Group and Lufthansa revealed its intention to take over Norwegian Airlines. There has not been any further news on this since June 2018. A potential acquisition of Norwegian Airlines could have different implications for Avinor depending on the acquirer group. We see no rating impact at this stage.
- We are revising our outlook to stable from negative and affirming the 'AA-/A-1+' ratings on Avinor.
- The stable outlook reflects our expectation that over the next 18 months, Avinor will continue to deliver solid adjusted FFO to debt of above 13% through its network of airports and Air Navigation Business, which will remain unchanged.

Rating Action

On Sept. 28, 2018, S&P Global Ratings revised its outlook on Norway-based airport and air traffic controller Avinor AS to stable from negative. At the same time, we affirmed the 'AA-/A-1+' long- and short-term issuer credit ratings on Avinor and the 'AA-' issue rating on its senior unsecured debt.

Rationale

The outlook revision and affirmation reflect our expectation that Avinor's strong EBITDA generation should enable the group to maintain solid operational and financial performance despite high capital expenditure (capex) needs and uncertainties around disputes with Norwegian armed forces as well as potential pension changes.

We also understand from the Norwegian government that it hasn't yet decided on the timing or process to initiate the demerger of the ANS subsidiary of Avinor, Avinor Flysikrings AS. This supports our current view of a very high likelihood of government support to Avinor if needed.

In April 2018, International Airline Group revealed its intention to take over Norwegian Airlines, which was followed by a bid by Lufthansa. There has been no further news on this since June 2018. A potential acquisition of Norwegian Airlines could have different implications for Avinor depending on the acquirer group, possibly implying more dramatic cuts of lossmaking routes, more rational management toward Norway, or a move of the long-haul flights toward other hubs.

Avinor's 2017 financial performance was better than our expectations; it posted a 6.8% increase in revenue year-on-year at Norwegian krone (NOK) 11.5 billion, and EBITDA growth of 5.5% to NOK3.8 billion. Avinor faced a number of one-off expenses in 2017 related to pensions and compensation costs, which led to a slight deterioration of credit metrics compared with our forecasts. The company's funds from operations (FFO) to debt at 12.9% was slightly weaker than our forecast of 13.2%, driven by higher reported debt and increased pension obligations. That said, we see such one-off expenses as non-recurrent and forecast that the company will be able to sustain a weighted-average ratio of FFO to debt for 2018-2020 of comfortably above 13%, which we consider to be commensurate with its financial risk profile.

Increasing international tourism, in particular, continues to drive growth in air passenger numbers. We forecast a continuation of traffic growth trend line of around 3% (January to May 2018 traffic increased by 2.6% year-on-year). Decommissioning of the Rygge airfield (secondary Oslo airport) has strengthened Oslo's position as an international hub in the Nordic region.

Our business risk assessment for Avinor continues to reflect 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 83%) share of origin and destination traffic, which we consider to be generally less susceptible to passenger choice and airline performance than transfer. Our assessment also reflects Avinor's fairly resilient S&P Global Ratings-adjusted EBITDA margin, which we forecast will range between 34% and 36% in 2018-2020. We consider the group's profitability to be underpinned by solid operating performance in the large airports such as Oslo Gardermoen, which accounts for about two thirds of the group's earnings. Compared with its peer group, Avinor's business risk is somewhat constrained by the significant presence of lossmaking airports in its portfolio. These regional and local airports are economically and socially important but, in addition to lowering financial performance, bring a wider range of business issues and use higher human and capital resources than the comparable peer group.

Our assessment of Avinor's financial risk profile is based on our expectation of increasing financial leverage and a slight deterioration of its credit measures due to the accelerated and partly debt-funded capital investments to expand and enhance the airports' infrastructure and ongoing disputes with the armed forces.

Our base-case scenario assumes:

- Real GDP growth in Norway of 2.0% in 2018 and 2019. We typically see a relationship between GDP growth rates, passenger numbers at the airport, and retail spending.
- Estimated annual passenger volume growth of 2.5%-3.5% in 2018 and 3.0%-3.5% growth in 2019.
- Revenues rising at a similar level as the traffic in 2018-2019, also supported by steadily improving and expanding commercial operations, and average tariffs increasing broadly in line with the consumer price index of Norway.
- We expect the new terminal at Oslo airport, which opened in April 2017, to boost commercial revenues in 2018 and beyond. We have included in our forecasts real increases on a per passenger-basis above the trend line.
- The duty free contract with Heinemann is expiring in 2022 and the government shareholder has indicated that it would like to revisit the current model. The options would include a retendering, an inhouse operation by Avinor, or having Vinmonopolet (the government-owned alcoholic beverage retailer) taking over the operations.
- Average adjusted EBITDA margin of about 34%-36% in 2018-2020 thanks to a cost control policy.
- Annual capex of NOK3.0 billion-NOK4.0 billion in 2018-2020.
- Distribution of about NOK250 million in 2018 followed by NOK600 million in 2019.

Based on our assumptions, we expect weighted-average credit metrics will remain in line with our financial risk profile assessment:

- S&P Global Ratings-adjusted FFO to debt of about 14%-15% in 2018-2020.
- Adjusted debt to EBITDA at about 5x-6x in 2018-2020.
- Adjusted EBITDA margins at about 34%-36% in 2018-2020.

We consider Avinor as 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 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 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. We don't expect Avinor to be fully privatized in the next 24 months but the air navigation business could be spun off at some point, which might lead us to revise our opinion on the likelihood of government support for Avinor.

Liquidity

We consider that Avinor's strong liquidity profile is supported by its liquidity sources (such as the undrawn long-term revolving credit facility [RCF] and available cash holding), ability to generate solid operating cash flows, and demonstrated access to capital markets. These sources compare favorably with its liquidity uses, particularly mandatory debt repayments and high capex.

Our base-case liquidity assessment for the 12 months from June 30, 2018 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 complies 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 at least 30%. As of year-end 2017, Avinor's equity ratio was about 40%, which implies comfortable 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 is likely to be able 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 12 months from June 30, 2018, include:

- Available cash and cash equivalents of about NOK1.56 billion;
- A fully available NOK4 billion RCF due in June 2020;
- Overdraft limit of NOK600 million due November 2020; and
- Forecast operating cash flows of about NOK3.5 billion.

Principal uses of liquidity over the same period include:

- Short-term debt of about NOK672 million;
- Expansionary (and to some extent discretionary) and maintenance capex of approximately NOK3.0 billion-NOK3.5 billion; and
- Discretionary dividends of NOK425 million.

Outlook

The stable outlook is driven by our expectation of continuing strong operational and financial performance over 2018-2020 and confirmation from the Norwegian government that it does not plan to initiate a demerger process of the ANS subsidiary, Avinor Flysikrings AS. At the current rating levels, we expect that Avinor will be able to achieve a weighted-average ratio of adjusted funds from operations (FFO) to debt of more than 13%.

Downside scenario

We could lower the rating if Avinor's cash flow ratios materially deviate from our base case with adjusted FFO to debt falling below 13%. Given the company's significant and partly debt-funded expansionary capex, Avinor could be unable to achieve steady earnings growth and credit measures commensurate with the rating. For example, if capex investment exceeds the budget, passenger volumes fail to continue their strong upward trend, or the new commercial openings underperform.

We could lower the ratings if the stance of the Norwegian government became unexpectedly inconsistent with a very high likelihood of support. We believe this could stem from, among other factors, 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 as a fall in the EBITDA margin sustainably below 30%) leading to a lower business risk profile assessment.

Upside scenario

We see limited rating upside given Avinor's large capex needs, which constrain its ability to meaningfully reduce leverage over the next 18-24 months.

Ratings Score Snapshot

Issuer Credit Rating: AA-/Stable/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)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (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)

SACP--Stand-alone credit profile.

Issue Ratings--Subordination Risk Analysis

Capital structure

Avinor's capital structures mostly consist of senior unsecured debt issued at the parent level.

Analytical conclusions

Avinor's debt is rated 'AA-', the same level as the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- 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
- 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

Ratings List

Ratings Affirmed; Outlook Action

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

Additional Contact:
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