



RATING ACTION COMMENTARY

Fitch Affirms Heathrow Funding's Class A Notes at 'A-', Outlook Stable

Mon 06 Apr, 2020 - 5:55 AM ET

Fitch Ratings - London - 06 Apr 2020: Fitch Ratings has affirmed Heathrow Funding Limited's class A and B bonds at 'A-' and 'BBB', respectively, with Stable Outlooks. Fitch has also affirmed Heathrow Finance plc's outstanding notes at 'BB+' with a Stable Outlook.

RATING RATIONALE

The affirmations reflect our expectation that Heathrow's financial flexibility in the form of largely deferrable shareholder distributions, together with its ability to reduce its cost base, will enable it to deleverage below our rating sensitivities after a severe coronavirus-related volume shock in 2020, followed by gradual recovery between 2021-2024. In our view, Heathrow's primary hub status together with its capacity constraint and consequent demand for airline slots in significant excess of supply is likely to support a quicker recovery than other airports. Heathrow's liquidity position is vast in part due to significant debt issuance in 2019 ahead of anticipated capex related to the third runway project, which we now expect to be significantly delayed.

Heathrow Funding Limited is the issuer of Class A and Class B debt and Heathrow Finance plc is the holding company, which is the high-yield issuer.

We currently assume the 2020 shock to be progressively recovered but if the severity and duration of the outbreak are longer than expected, the rating case will be revised accordingly.

KEY RATING DRIVERS

Coronavirus, Travel Restrictions Affect Demand: The rapidly spreading of coronavirus is leading to an unprecedented impact on travellers' mobility. Under our revised rating case, we assume traffic to fall by about 20% in 2020, remain about 5% below 2019 levels in 2021 and gradually recover thereafter. Heathrow's role as a primary hub offering strong yield for its resident airlines, its location and connectivity and the attractiveness of London as an international business center, together with the capacity constraint due to which demand for slots exceeds supply all support Heathrow's resilience to shocks.

Defensive Measures Provide Flexibility: Heathrow's significant balance-sheet flexibility and the management and shareholders' commitment to the current rating provide some degree of comfort. Operating costs are partly variable. We continue to expect significant delays in expansionary capex and very little spending on the third runway project in 2020, which should support liquidity during this period. Shareholder distributions in case of significant revenue shortfalls can also be deferred.

Credit Metrics Recover from 2021: Under the updated FRC, after the 2020 shock causing a peak in Fitch-adjusted net debt to EBITDAR of above 9.5x for the Class A debt, above 10.7x for the Class B debt and above 12.6x for the high-yield debt, Heathrow's leverage falls below our downgrade sensitivities of 8x, 9x and 10x, respectively, for the three classes in 2021 in our rating case. This suggests only a temporary impairment of its credit profile. We are closely monitoring the development in the sector as airports' operating environment has substantially worsened and will revise the FRC in case the severity and duration of coronavirus is longer than expected.

We ran two version of the FRC with a lower (3.6%) and a higher (5.3%) WACC assumption for the H7 period starting in 2022. Even under the lower WACC

scenario, assuming a two-year delay in capex, leverage metrics under this scenario remain within the ratings thresholds. We note that under our lower WACC scenario, management may not choose to undertake the third runway expansion due to inadequate returns to shareholders from the substantial investment.

Solid Liquidity: Heathrow Funding Limited has cash and committed undrawn liquidity of about GBP3.0 billion as of March 2020, providing sufficient liquidity in the FRC. At present, Heathrow Finance has over GBP200 million in cash, plus significant additional issued delayed drawdown debt which will be drawn between March and May 2020. The cash is expected to be retained to ensure it has sufficient liquidity on a standalone basis. Heathrow Finance has no large debt maturities until 2024.

Sensitivity Case: We have also run a sensitivity case where Heathrow's traffic falls by about 30% in 2020 with gradual recovery thereafter. Leverage for all three classes of debt have higher peaks in 2020 in this scenario but deleverage below the downgrade sensitivities thereafter. We ran both lower and higher WACC versions of this scenario as well; leverage under this scenario assuming lower WACC starts rising towards 2024 due to expansion capex ramp up. We assumed zero shareholder equity contribution to the capex in our forecast, though we expect that there will be equity contributions sized to maintain Heathrow Funding's existing investment grade ratings.

Risk Assessments: Fitch assesses Heathrow's volume risk as 'Stronger' and price risk, infrastructure renewal and debt structure all as 'Midrange' (for more information see the last full review "Fitch Affirms Heathrow Funding's Class A Notes at 'A-', Outlook Stable" dated 31 May 2019)

RATING SENSITIVITIES

Factors That May, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

An upgrade is unlikely given our expectations of significant traffic reductions in 2020-21, and the uncertainties around the runway expansion project as well as the WACC for H7.

Factors That May, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

Class A notes: net debt to EBITDA consistently above 8x

Class B notes: net debt to EBITDA consistently above 9x

HY notes: net debt to EBITDA consistently above 10x

Deterioration of aviation industry beyond our current expectations due to a more severe or prolonged period of travel restrictions or consequent economic downturn due to coronavirus.

Weakening of Heathrow management and shareholders' commitment to the existing investment-grade ratings for Class A and Class B Debt

Expansion plans that included a WACC and/or level of shareholder contribution insufficient to maintain leverage sustainably within our negative rating thresholds

BEST/WORST CASE RATING SCENARIO

Ratings of Infrastructure and Project Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings <https://www.fitchratings.com/site/re/10111579>.

TRANSACTION SUMMARY

Heathrow is a major global hub airport with significant origin and destination traffic and resilience due to its status as the preferred London airport and capacity

constraints. Peers include Aeroports de Paris, in terms of size, and Gatwick, in terms of location and debt structure.

Revenues are regulated and subject to an inflation price cap on a single till basis. We view the structured, secured and covenanted senior debt as offsetting some of the higher expected five-year average leverage under the Fitch rating case for the class A and B bonds compared with peers. The HY bonds are, by nature, structurally subordinated.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			
Heathrow Finance plc				
● Heathrow Finance plc/Debt/3 LT	LT	BB+	Affirmed	
● Heathrow Finance plc/Debt/5 LT	LT			

ENTITY/DEBT RATING**[VIEW ADDITIONAL RATING DETAILS](#)**

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

[Infrastructure and Project Finance Rating Criteria \(pub. 24 Mar 2020\) \(including rating assumption sensitivity\)](#)

[Airports Rating Criteria \(pub. 24 Mar 2020\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Third-party Model ([24 March 2020](#))

ADDITIONAL DISCLOSURES

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Heathrow Finance plc EU Issued

Heathrow Funding Limited EU Issued

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