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CREDIT OPINION
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# Kenton County Airport Board, KY

Update to credit analysis

## Summary

The Kenton County Airport Board's (A1 stable) credit profile reflects the airport's diverse revenue base, with substantial growth in cargo volume that is meaningfully offsetting the decline in passenger traffic; robust liquidity to manage cost pressures and navigate risks around the ongoing recovery in air travel for several years; good financial management, demonstrated by a conservative financial position maintained through the COVID shock; and significant financial flexibility over the medium to long term, supported by low leverage and limited expansion capex.

The credit profile incorporates strong growth in passenger and cargo volumes pre-COVID; material improvements in cost per enplanement, debt service coverage and liquidity due in part to increased revenue retention from a hybrid rate-making framework; and a low debt burden combined with limited planned expansion, partially tempered by a relatively elevated adjusted net pension liability. The airport continues to benefit from its position as the primary commercial airport for the Cincinnati metropolitan economy, with a manageable level of competition that is mostly at the periphery of the service area.

## Credit strengths

» Low cost burden, reflected in favorable airline cost per enplanement (CPE) and debt per O&D enplanement

» Increased activity by DHL and the implementation of Amazon Air's hub have driven robust growth in cargo

» Passenger service offering has been diversifying and expanding, resulting in lower airfares and increased connectivity, which has stimulated travel demand and increased market share within the catchment area

» Greater Cincinnati area has a balanced, durable and stable economic base

» CVG has airfield and terminal capacity to comfortably accommodate growth for the foreseeable future

## Credit challenges

» Relatively large adjusted net pension liability (ANPL)

» Expected cost shift when Delta's existing terminal agreement expires in 2021

» Uncertain scope of capital plan

## Rating outlook

The rating outlook is stable, reflecting our expectation of steady to growing overall activity based on continued recovery in air travel and strength in cargo; maintenance of healthy liquidity, with good cost recovery under the existing airline agreement, over 500 days of cash on balance sheet in addition to an undrawn credit facility and remaining federal grant funds; and flexibility from a stable cost base, with low airline CPE and low debt service, and manageable capital spending.

## Factors that could lead to an upgrade

» The rating could be upgraded if the airport maintains its current strong financial profile while experiencing meaningful and sustained increases in passenger and cargo levels

## Factors that could lead to a downgrade

» Significant deterioration of key financial metrics (such as debt service coverage, days cash on hand and debt per O&D enplanement) relative to current levels

» Materially weakened air service profile and market position

## Key indicators

Exhibit 1

**Kenton County Airport Board**

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Enplanements (000) | 3,160 | 3,384 | 3,926 | 4,440 | 4,554 |
| Cargo tons | 804,088 | 818,364 | 1,041,890 | 1,241,320 | 1,248,779 |
| Debt per O&D enplanement ($) | 25.46 | 15.48 | 12.20 | 10.21 | 16.84 |
| CPE ($) | 9.17 | 6.9 | 5.85 | 4.49 | 4.51 |
| DSCR | 1.25 | 4.16 | 5.01 | 6.01 | 6.21 |

*Source: Moody's Investors Service*

## Profile

Kenton County Airport Board owns and operates the Cincinnati/Northern Kentucky International Airport (CVG), a medium hub commercial airport located approximately 13 miles southwest of downtown Cincinnati (Aa2 stable). At 4.6 million enplanements in 2019, CVG is the largest airport in Kentucky and, although not physically located in Ohio, would be the second largest airport in Ohio behind Cleveland. With 1.25 million tons of cargo in 2019, CVG ranked as the sixth largest cargo airport in the US.

## Detailed credit considerations

### Revenue Generating Base

**Strong performance through COVID, bolstered by cargo**

Kenton County Airport Board has fared better than most airports through the coronavirus pandemic. A major air cargo hub – the sixth largest cargo airport in the US – Cincinnati is being bolstered by a surge in air cargo activity following the onset of COVID, which is meaningfully offsetting the loss of passenger traffic. The airport is experiencing stable overall activity, with total landed weight only 7% below 2019 levels despite significantly lower passenger enplanements.

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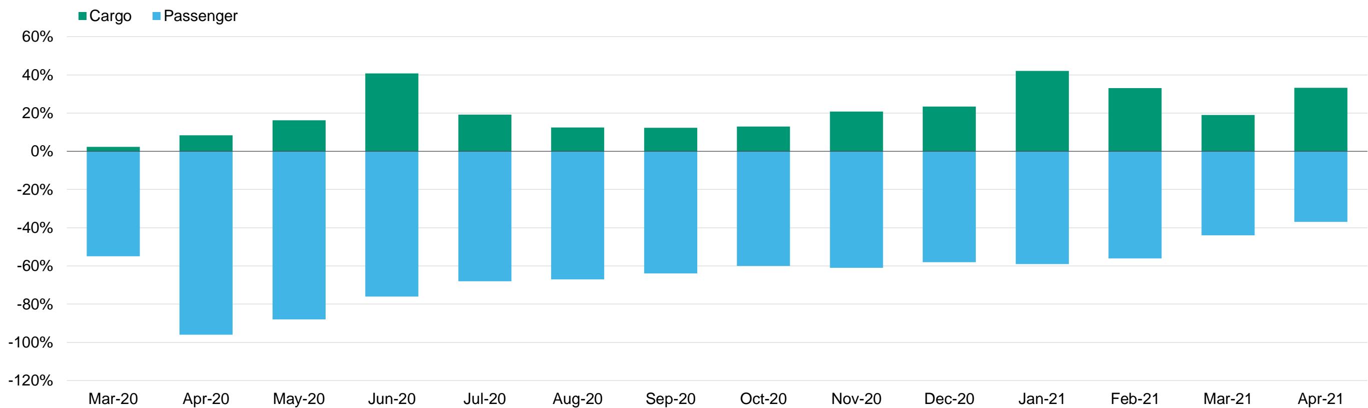
Exhibit 2

**Double-digit cargo growth has helped balance passenger declines**

**Cargo tons and passengers versus prior year, March 2020 onward versus 2019**




*Source: Kenton County Airport Board*

Cargo activity is being driven by the significant reduction in passenger aircraft belly capacity on the supply side, along with growth in e-commerce and increased spending on goods on the demand side. This favorable set up will continue over the next 12-18 months given ongoing vaccine distribution, continued growth in e-commerce, improving global economic activity and ongoing pressure on passenger belly capacity. The International Air Transport Association (IATA) expects long-haul belly cargo capacity will not return to pre-pandemic levels before 2024, which will continue to benefit the cargo carriers and freighters that use CVG.

**Air travel is recovering in line with the sector**

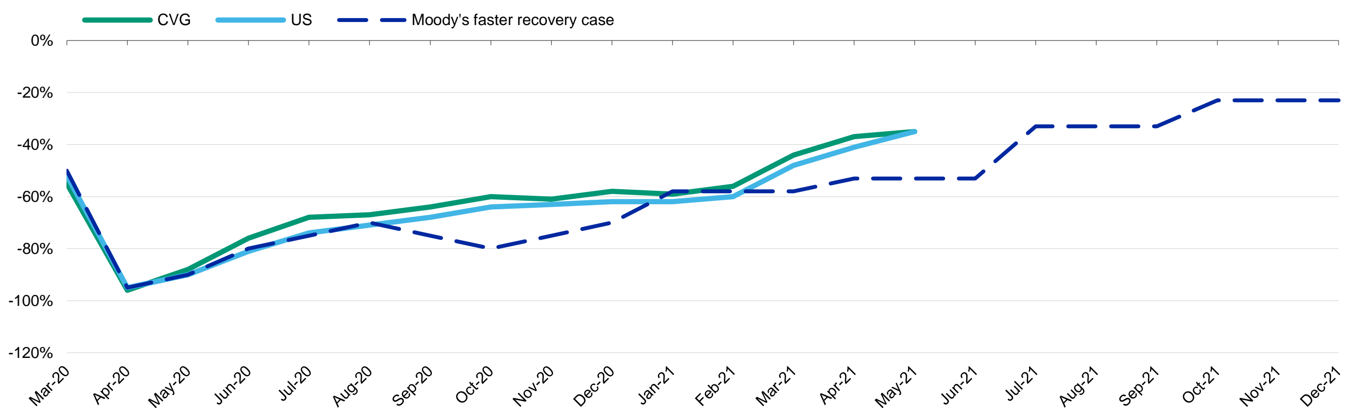
Passenger activity has been impacted by COVID but is recovering well and will be the primary driver of revenue growth over the next 12 months.

Passenger activity at CVG is mirroring that of the broader sector, reflecting an increasingly robust recovery that is exceeding our faster recovery case forecast.

Exhibit 3

**CVG's recovery is tracking the sector, exceeding Moody's faster recovery case**

**Passenger activity versus prior year, March 2021 onward versus 2019**




*Source: Kenton County Airport Board, TSA, Moody's Investors Service*

Passenger throughput was at 65% of 2019 levels in May 2021, compared to roughly 40% in January 2021 and 10% in May 2020. We expect enplanements will reach 70% (of 2019 levels) by the end of 2021 and 85% by the end of 2022. The growth reflects a combination of strengthening demand and increasing supply. Airline seat capacity has increased to 80% (of 2019 levels) in June 2021, from 60% in January 2021 and 30% in June 2020, and also exceeds Moody's and industry consensus recovery forecasts.

**O&D demand underpinned by stable service area**

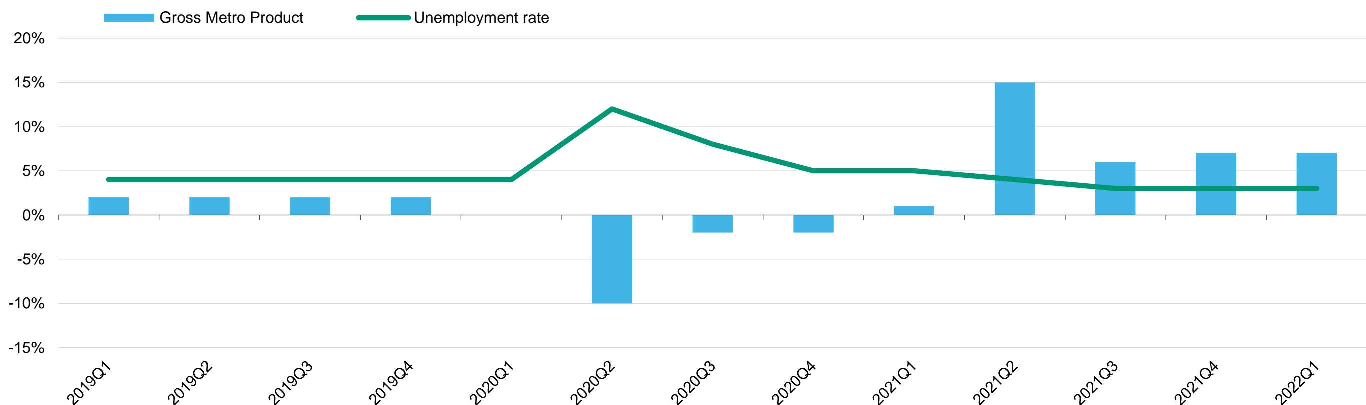
The airport is the dominant provider of commercial air service for O&D passengers in the Greater Cincinnati area.

The service area has a diverse, and stable, economic base and a population of roughly 2.2 million. Conditions within the service area are normalizing and we expect strong economic growth over the next 12-18 months, which will combine with pent-up travel demand to bolster air travel at CVG.

Exhibit 4

**Cincinnati metropolitan area economic outlook is strong as activity normalizes**

**Annual change (GMP) and rate (unemployment), actual and projected**




*Source: Moody's Analytics*

The economy has good industrial diversity and is a regional economic center with a sound demographic profile, which should support long-term travel demand generation even in a post-COVID world. Moody's Analytics expects that "… over the long term, Cincinnati will outpace the rest of the Buckeye State due to robust demographics and a skilled workforce."

## Financial Operations and Position

**Robust flexibility to navigate recovery from COVID**

The airport has excellent financial flexibility to manage through the uncertain recovery in air travel. This is reflected in very strong liquidity, low charges to airlines, low leverage and limited pressure from capital spending. The financial position is further supported by a hybrid airline agreement with extraordinary coverage protection, in effect through 2021, which buttresses cost recovery while passenger volumes normalize.

The airport used a combination of federal grants, cost reductions and spending deferrals in response to COVID. These actions have helped control airline costs below $10 and created flexibility to operate through a potentially extended period of weak activity. Actual activity is outperforming management's planning case, but the budget flexibility and balance sheet capacity established for a more challenging environment remain intact.

The financial profile is principally supported by robust liquidity. This includes $166 million, or 730 days, of cash on hand; roughly $85 million of unused federal grants, equivalent to 360 days of O&M; and full availability under a $75 million credit facility. These resources are substantial relative to a passenger airline rate base of less than $25 million, or relative to airport debt service of $6 million, and allow the airport to withstand a materially more adverse environment than the one currently taking shape.

The financial position will be supported by increased stability in passenger activity. Throughput continues to recover in line with the broader sector, which will drive improvement in non-airline revenue and extend the support potential of federal grants. We expect the airport will end 2021 with airport passengers at 75% of 2019 levels, airline CPE below $10, in excess of 700 days cash on hand, and over $60 million of unused federal grants and $75 million of available capacity under the bank credit facility. The strong cargo activity has allowed the airport to more fully target support to passenger airline cost centers, and the existing resources afford the ability to mitigate cost pressures for several more years as enplanement levels recover. Operating costs have increased modestly as a result of certain Delta responsibilities being assumed by CVG in 2021.

Moody's net revenue debt service coverage ratios are robust, over 6.0x in 2019 and expected over 3.0x in 2020 and 1.5x 2021. Given the net revenue sharing in the airline agreement, DSCRs should improve as increases in activity and non-aeronautical revenue drive higher cash flow for the airport.

**Airline agreement extended through 2021**

CVG currently operates under a one-year extension of the five-year hybrid airline use agreement entered into in January 2016. The airfield uses a cost center residual framework and the terminal a commercial compensatory framework. The agreement also establishes airport/board cost centers. The airport may charge the signatory airlines extraordinary coverage payments, with these payments allocated to the airfield cost center requirement. The agreement provides for application of a terminal concession credit and net revenue sharing applied on an escalating percentage basis. The agreement also affords the airport greater control over facilities and capital planning, with specified majority-in-interest disapproval.

**Liquidity**

The airport ended 2020 with over 700 days cash on hand, roughly $85 million of unused federal grant (CARES, CRRSA and ARPA) funding and an undrawn $75 million credit facility. Approximately $23 million of federal grants will be used to manage airport (including concession relief) costs in 2021, indicating $63 million remaining entering 2022. The $75 million credit facility will remain in place through 2024.

## Debt and Other Liabilities

The airport's debt level is very manageable and totals $73 million at the end of 2019, or 0.7x operating revenue and $16 per enplaned passenger. We calculate the airport's adjusted net pension liability at close to $172 million, which brings the adjusted debt per enplaned passenger to about $54.

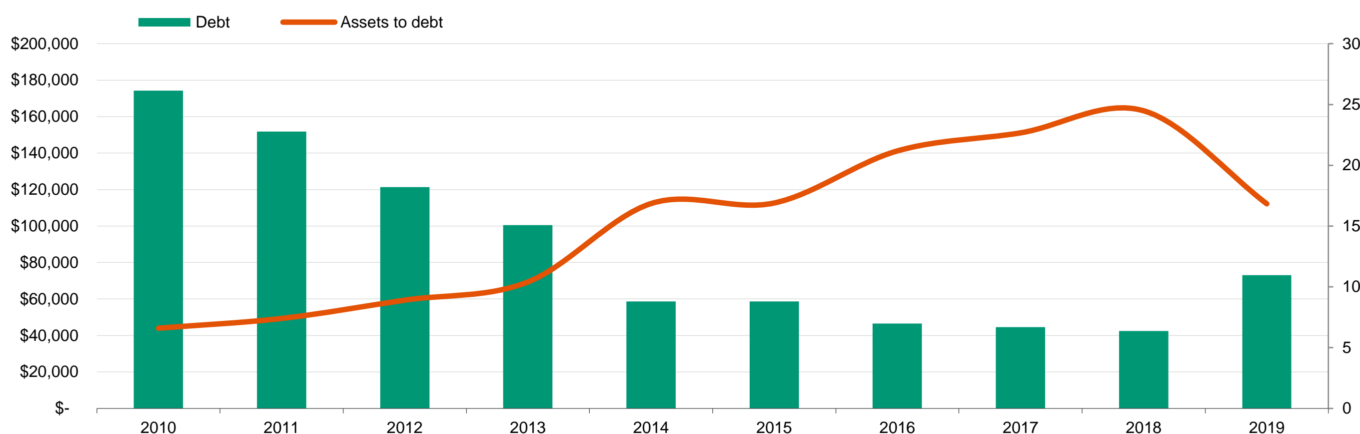
Despite a modest new issuance in 2019, debt has been declining. CVG's facilities are capable of accommodating foreseeable growth in airfield and terminal use, although there may be needs to modernize certain terminal areas, particularly to align with the changed nature of the now smaller O&D operations from that of the larger connecting hub for which it was built.

No new debt is anticipated at present; debt service charges are level, mitigating cost pressures on customers; and the airport has significant long-term debt capacity which it can utilize to minimize the financial impact of any new borrowing.

Exhibit 5

**Debt has declined and is expected to remain low**

**In thousands**




*Source: Kenton County Airport Board*

**Legal security**

The 2019 bonds are secured by net general airport revenues, including any PFCs the airport elects to allocate toward eligible debt service on the bonds, although the airport has not expressly committed to allocate eligible PFCs other than to the 2016 bonds. The 2019 bonds and 2016 bonds are secured by a common debt service reserve fund sized at the three-prong test and funded in cash. The

rate covenant requires that net revenues plus a Carryover Amount of unrestricted general purpose funds, in an amount not to exceed 25% of debt service requirements in the next fiscal year, equal at least 1.25x debt service.

**Debt structure**

The Series 2016 bonds amortize with level debt service of $4.3 million annually through 2032, representing an annual obligation that is easily covered by PFCs (approximately $17.3 million collected in fiscal 2018) – 100% of debt service is eligible to be paid from PFCs – and represents a modest and predictable charge.

The approximately $2.3 million of debt service on the Series 2019 bonds will be paid from airport cost centers, although approximately 90% of debt service is PFC-eligible.

**Debt-related derivatives**

None.

**Pensions and OPEB**

The airport has a relatively large adjusted net pension liability (ANPL).

All full-time employees of the airport participate in the Kentucky Retirement Systems' (KRS) County Employees Retirement System (CERS), a cost-sharing multiple-employer defined benefit pension system consisting of two employee plans, Hazardous and Nonhazardous. The airport reported a net pension liability associated with these plans of $97 million at the end of 2019. With Moody's standard adjustments to reported pension data, we calculate an ANPL of $172 million. The main difference between the airport's reported net pension liability and Moody's ANPL is the rate used to discount the pension liability, which was 6.25% for the airport and 3.51% for Moody's.

## ESG considerations

### Environmental

The primary risk is a reduction in passengers if more stringent air emission and carbon regulations on airlines significantly increase airfares. This would have the greatest impact on airports that have increased leverage to expand capacity. Airports may face more regulation regarding air quality, including noise pollution, in and around airports. Disasters (SARS, Icelandic volcanoes, hurricanes) can temporarily reduce volumes. Airports encounter a manageable level of soil pollution exposure, through fuel leaks, de-icing fluids, and by-products from fire fighting activities. New airports in expanding markets may also face environmental issues depending on the environmental sensitivity of the proposed sites. The sector is generally able to pass along added costs stemming from these exposures. Growth in demand for air travel, particularly long-haul routes, which are most exposed to costs of carbon legislation, will likely remain steady, leading to increasing carbon costs with growing passenger volumes. We do not see any major environmental risk for this issuer.

### Social

Airports can be at risk of social factors such as labor agreements and noise issues with communities. The severe traffic disruption to enplanements caused by the COVID-19 outbreak will continue to have an impact on air travel.

### Governance

The Kenton County Airport Board was created pursuant to a resolution of the Fiscal Court of Kenton County, Kentucky, adopted on June 3, 1943, and has jurisdiction, control, possession and supervision of the airport. Under the provisions of Chapter 183 of the Kentucky Revised Statutes and by the terms of such resolution, the board has been created and organized as a public body politic and corporate. Recent legislation has established a new board structure with 13 voting members: 8 of whom are appointed by Kenton County; 2 by Boone County; and one each by Campbell County, Grant County, and the Governor of Kentucky. The non-voting advisory committee was eliminated.

## Rating methodology and scorecard factors

The principal methodology used in this rating is Publicly Managed Airports and Related Issuers rating methodology published in March 2019. The scorecard indicated outcome of Aa3 is one notch above the assigned rating of A1 and does not yet incorporate enplanement volatility and changes in debt service coverage and leverage metrics resulting from the impact of COVID.

Exhibit 6

**Publicly Managed Airports and Related Issuers**

| Regional Position: | Regional | | |
|---|---|---|---|
| **Rate Making Framework:** | Compensatory | | |
| | | | |
| **Factor** | **Subfactor** | **Score** | **Metric** |
| 1. Market Position | a) Size of Service Area (millions) | Aa | 2.2 |
| | b) Economic Strength and Diversity of Service Area | A | |
| | c) Competition for Travel | A | |
| | | | |
| 2. Service Offering | a) Total Enplanements (millions) | Aa | 4.55 |
| | b) Stability of Traffic Performance | A | |
| | c) Stability of Costs | Baa | |
| | d) Carrier Base (Primary Carrier as % of Total Enplanements) | Baa | 45% |
| | | | |
| 3. Leverage and Coverage | a) Net Revenue Debt Service Coverage | Aaa | 6.2x |
| | b) Debt + ANPL (in USD) per O&D Enplaned Passenger | A | $53.00 |
| | | | |
| **Preliminary Scorecard Indicated Outcome:** | | **A1** | |
| | | | |
| | | **Metric** | **Notch** |
| 4. Liquidity | Days Cash on Hand | 730 | 1.0 |
| | | | |
| 5. Connecting Traffic | O&D Traffic | 95% | 0.0 |
| | | | |
| 6. Potential for Increased Leverage | | | 0.0 |
| | | | |
| 7. Debt Service Reserves | | | 0.0 |
| | | | |
| **Scorecard Indicated Outcome:** | | **Aa3** | |

*Source: Moody's Investors Service*

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