Research Update:

Royal Schiphol Ratings Lowered To 'A-/A-2' On Reduced Capacity Cap; Outlook Stable

July 21, 2022

Rating Action Overview

- We believe that the Dutch government's intention to reduce annual aircraft movements to 440,000 from 500,000 at Royal Schiphol Group's (Schiphol's) Amsterdam Airport Schiphol may hinder the airport's growth prospects and its competitive position as a hub airport from 2023.
- As such, we do not expect traffic to return to 2019 levels over the next five years, leading to a slower deleveraging path than we previously anticipated.
- Despite quicker traffic recovery for 2022 than our previous projections and high inflationary pressure, we forecast funds from operations (FFO) to debt will remain below 8% into 2023.
- We therefore lowered to 'A-/A-2' from 'A/A-1' our long- and short-term issuer credit ratings on Schiphol, and to 'A-' from 'A' our issue ratings on Schiphol's senior unsecured debt.
- The stable outlook reflects our expectation of continued traffic recovery, and that Schiphol will effectively manage its cost base and capital spending, such that its ratio of FFO to debt will be above 6% from 2023.

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Rating Action Rationale

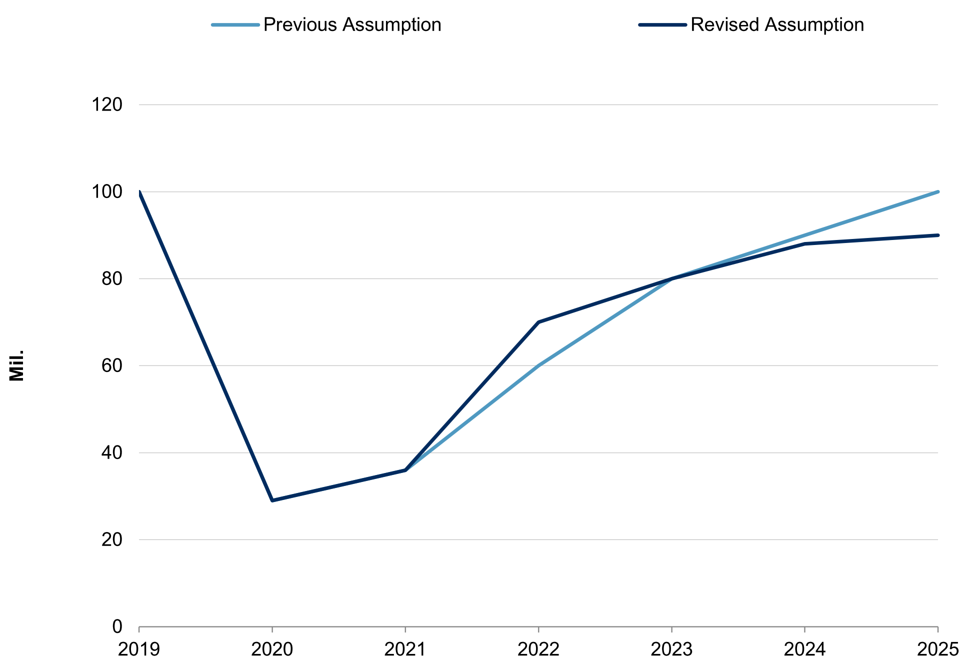
We believe the lower capacity cap on aircraft movements (ATMs) at Amsterdam Airport Schiphol could weigh on Schiphol's competitive position as a hub airport. On June 24, 2022, the Dutch ministry of transport announced its intention to lower the capacity cap to 440,000 ATMs from 500,000 ATMs per year. The objective is to decrease aviation emissions and noise at the airport. The lower cap increases the severity of the initial 500,000 ATM cap introduced in 2015. We believe that the new capacity cap, starting from its expected implementation in third-quarter 2023, will limit passenger growth prospects for Schiphol. Although airlines could increase its aircraft sizes or load factors to carry more passengers, the lower ATM limit could result in less connections, since Amsterdam Airport Schiphol will be obliged to reduce the number of slots that it offers. We believe this could jeopardize Amsterdam Airport Schiphol's hub status over the longer term, making the airport less attractive than other European hubs, such as Heathrow or Aeroport de Paris's Charles de Gaulle. What's more, the introduction of the cap coincides with Schiphol's ongoing delays in the opening of the airport in Lelystad. Despite being operational since 2018, this airport may not open until mid-2024, at the earliest, due to the pending authorization of environmental permits. Otherwise, such an asset could have captured some of the operations Schiphol will lose due to the cap.

We see heightened risk of environmental policy objectives potentially hampering Schiphol's operations in the longer term. We note that there could be delays in the timing of the capacity cap's implementation, which is subject to an EU notification and consultation process that could take at least nine months. Nevertheless, as the Netherlands advances towards its goal of reaching 49% of 1990 emissions by 2030, Schiphol may be exposed to increasing government intervention or regulations that directly impact the credit profile of the company. We anticipate that the capacity cap will be in place for five years, while the government develops alternative environmental limits that may replace the cap. Although it is not clear at this stage how the government will implement these limits, we see heightened risk of environmental policy objectives potentially hampering Schiphol's operations in the longer term. For instance, the government could opt to roll out an even more demanding capacity cap.

We now expect Schiphol's recovery path will be longer than earlier assumptions. We no longer envisage a return to 2019 levels, at least not over the coming five years. We anticipate that the lower capacity cap in ATMs could translate into passenger volumes being 5%-8% lower than 2019 levels, even by 2026. The cap would lower ATMs by 12% from 2019 levels. However, we expect a more moderate impact on passenger numbers since airlines could use larger aircraft or have higher load factors, or there are shifts from cargo slots to passenger aircraft. In the nearer term, we anticipate that Schiphol's passenger traffic will exceed our previous estimates of 60%-65% of 2019 levels in 2022. We now expect that the removal of mobility restrictions, high-pent up demand, and accumulated disposable incomes will likely support passenger volumes of 70% of 2019 levels in 2022. However, as inflation starts to bite, disposable incomes diminish and business and Asia-Pacific travel continues to lag, we expect that passenger traffic recovery could decelerate from fourth-quarter 2022. This leads us to maintain our previous estimate that passenger volumes in 2023 will reach 80% of 2019 levels.

Chart 1

Schiphol Passenger Number Recovery Path
Number of passengers, Indexed 2019=100



Source: S&P Global Ratings' estimates.

Combined with high inflationary pressure, Schiphol's post-pandemic deleveraging will likely take longer. Given the weaker operating environment alongside Schiphol's lower margins and high committed spending, we forecast Schiphol's FFO-to-debt ratio will remain below 8% even in 2023. Because we believe the capacity cap will weaken Schiphol's earnings profile, we also expect the company to operate with lower leverage in order to restore its creditworthiness.

High inflationary pressure will likely constrain Schiphol's profitability over the next two years. As the Russia-Ukraine conflict persists, we anticipate that inflation for the Netherlands could reach 8.9% in 2022. As such, we forecast that Schiphol's margins will remain subdued at 20%-25% in 2022, before increasing to 30%-35% in 2023, from close to 40% before the pandemic. We believe margins are unlikely to return to 2019 levels over our forecast horizon given the slower passenger recovery path and inflationary environment. Although the company benefits from favorable contract structures that help buffer rising costs--such as energy hedges until 2024 and inflation-linked real estate rents--65%-75% of the company's cost base is exposed to inflationary pressure. Collective labor agreements for 2022 locked in salary increases of 2.5% for the year. However, high operational bottlenecks and the requirement to offer incentive payments mainly to attract third-party operational staff, such as security and baggage handling, as the recovery picks up will likely increase personnel costs over the year. Additionally, Schiphol is entitled to pass-through aviation costs in its tariff. That said, the tariff--which was implemented

April 1, 2022 for the regulatory period 2022-2024--incorporates an inflation assumption of around 2% over the period. We believe this will be lower than actual inflation. We do not expect Schiphol to be able to remedy the mismatch in cash flow until the next regulatory period from 2025, thereby intensifying the pressure on margins.

Despite the capacity cap, Schiphol will likely maintain its capital expenditure (capex) program. We don't think the capacity cap will prompt the company to adjust its spending plans over the next three to five years. We base our opinion on the long-standing requirements to increase terminal and associated infrastructure capacity. We expect that the company will still spend around €550 million in 2022 and €850 million-€900 million from 2023 to undo capacity bottlenecks and create sustainable efficiencies.

Schiphol's strong regulatory framework likely to offset the financial impact of the lower cap through higher tariffs, but could further hurt its competitive position. The 'A-' rating incorporates our belief that Schiphol will benefit from its well-established and supportive regulatory framework. It is one of the few European airports to benefit from a traffic-risk allocation mechanism. As such, we anticipate that the company should be entitled to compensation for lost revenue due to lower-than-expected passenger volumes over the current regulatory period (2022-2024) when the capacity cap is introduced, mitigating the impact of the cap. As such, we expect that the airport will be entitled to settlements for this lower traffic in the next regulatory period (2025-2027). Furthermore, although Amsterdam Airport Schiphol's airport charges are markedly lower than Heathrow's, it is not far behind Paris Charles de Gaulle's. As such, the implementation of sharp tariff increases, even though entitled, could be more difficult to implement without further affecting the company's competitive position in light of the lower capacity cap. We have observed a good track record of the airport's ability to implement its tariff in line with its regulatory framework. The new approved tariffs for the regulatory period 2022-2024, implemented at the start of April 2022, allows Schiphol to increase its tariff by 9%, with a 12% increase planned for the subsequent two years of the regulatory period. This incorporates settlements for the lower-than-expected traffic volumes in 2020 due to the pandemic.

We continue to believe that Schiphol benefits from a moderately high likelihood of extraordinary government support if needed. As such, we apply a two-notch uplift to our assessment of Schiphol's stand-alone credit profile (SACP). The lower capacity cap--although it is an initiative from the Dutch government--does not diminish Schiphol's importance to the Dutch state, nor does it impact the government's ability to support the airport if it were to face financial distress. We continue to believe that Schiphol has an important role for the Dutch government, given its essential infrastructure nature of the group's main asset, Amsterdam Airport Schiphol, as a key element of the Netherlands' open and export-oriented economy. In our view, there is a clear need for the airport to continue to operate without disruption, as any interruption of its operations could have an important impact on a sector of the economy. We also believe that Schiphol has maintained a strong link with the Dutch government, with a track record of the Dutch government supporting entities such as Schiphol.

Outlook

The stable outlook on Schiphol reflects our expectation that, underpinned by the recovery in air traffic, the company will effectively manage its cost base and capex, such that its weighted-average ratio of FFO to debt will be above 6% over the next two years.

Downside scenario

We could lower the rating by at least one notch if we believe that the quality of the company's earnings profile weakens further, either due to long-term structural shifts in the aviation industry as it emerges out of pandemic, or a material deterioration in its competitive position because of further environmental or other regulations that could adversely impact the company's stability and predictability in cash flows. A downgrade could also stem from further weakening of Schiphol's credit metrics, in particular if Schiphol failed to maintain FFO to debt above 6%. This could occur if Schiphol's passenger traffic is materially slower or if costs and spending are much higher than previously anticipated.

All else being equal, a one-notch downgrade of the Netherlands will not change the rating on Schiphol airport.

Upside scenario

We see limited ratings upside over the next 12-24 months. However, we might raise the rating on Schiphol if passenger traffic recovers materially faster than anticipated, with greater certainty over its operating environment, such that the company is able to sustain FFO to debt above 9%.

Company Description

Schiphol Group owns and operates the largest of the Dutch airports, Amsterdam Airport Schiphol, which is one of Air France-KLM's two major hubs. Before the pandemic, Amsterdam Airport Schiphol catered for almost 72 million passengers and is the third-largest airport in Europe by number of passengers and by cargo volumes. The airport has a virtual monopoly on air travel originating and ending in The Netherlands and continues to be a major driver of the Dutch economy.

The group is 70% owned by the state of The Netherlands--a fact that supports the rating--20% by the Municipality of Amsterdam, 2% by the Municipality of Rotterdam, and 8% by Groupe ADP. Schiphol Group has a cross-shareholding and co-operation agreement with Groupe ADP.

In addition to its operations in Amsterdam, a major capital city in Europe, Schiphol also owns and operates Lelystad Airport and Rotterdam Airport, and holds a 51% stake in Eindhoven Airport. Its international operations include an 8% stake in Groupe ADP, a 19.61% stake in Brisbane Airport, and a management contract for Terminal 4 of JFK Airport in New York.

Our Base-Case Scenario

Assumptions

- Passenger traffic as a proportion of 2019 levels will be about 70% in 2022, around 80% in 2023 and about 85%-88% in 2024.
- An increase in airport charges of about 9% in 2022, followed by a 12% increase in both 2023 and 2024.
- EBITDA margins improve to 20%-25% in 2022 and about 30% in 2023, supported by the company's recovery path and cost-savings during the pandemic. This is not withstanding our

assumption for inflation in the Netherlands, that we believe will increase to 8.9% in 2022 and 4.0% in 2023.

- Annual capex of about €550 million in 2022. However, we anticipate that this could increase to up to €800 million-€950 million in 2023-2024.
- No dividend distributions to shareholders.
- We do not currently factor into our forecast the orderly sale of the 8% cross-shareholding held by Royal Schiphol Group and Aeroport de Paris.

Liquidity

We assess Schiphol Group's liquidity as adequate, based on our expectation that liquidity sources will cover uses by more than 1.2x for the 12 months to March 31, 2023. In our view, management exercises prudent risk management, has a high standing in the credit markets, and its debt documents remain favorable, with limited covenant protections.

Our estimates of Schiphol Group's principal liquidity sources and uses for the 12 months ending March 31, 2023, are as follows.

Principal Liquidity Sources:

- Cash and cash equivalents of about €919 million; excluding EUR320m in deposits with maturities more than 3 months.
- Undrawn and committed credit facility that mature beyond 12 months of about €670 million.
- Estimated cash FFO of about €275 million.

Principal Liquidity Uses:

- Debt maturities of about €9 million over the next 12 months.
- Capex of about €650 million. This includes some growth capex, however we note that the company has some flexibility to manage the capex needs depending on once the funding is received for these projects.
- No dividends.

Covenants

Schiphol Group's loan agreements with the European Investment Bank (EIB) include an own-funds-to-total-assets covenant calculated as equity as a percentage of the total balance sheet. This ratio is tested annually and must remain higher than 30%. As of Dec. 31, 2021, the company was compliant with this covenant, with an on-funds-to-total-assets ratio of 38%.

Environmental, Social, And Governance

ESG Credit Indicators: To E-3, S-3, G-2, From E-2, S-4, G-2

In light of the lower capacity cap proposed by the Dutch government in order to curb emissions and noise pollution, we have revised our environmental credit indicator to E-3, from E-2. We have also revised our social credit indicator to S-3 from S-4 to reflect the lower pressure from health and safety considerations.

We now view environmental factors to have a moderately negative consideration in our analysis of Schiphol airport. The airport's exposure to noise pollution, the government's decarbonization targets and the subsequent regulatory constraints that have further limited airport capacity, are likely to impact the company's competitive position and growth prospects, in our view. We see an increasing pressure in Europe, and in the Netherlands in particular, to curb carbon emissions and align with the country's net zero carbon targets. Amid a weaker operating environment with rising inflation, we believe this will add strain and slow the company's deleveraging efforts following the height of the pandemic. We no longer expect the airport to recover it's 2019 passenger levels over our projection horizon, which will weigh on the company's cashflow. Potentially offsetting this, however, are the airport's supportive regulations allowing a traffic-risk sharing mechanism, which should entitle the company to compensation for lost revenue due to lower traffic volumes because of the lower capacity cap and the pandemic, as well as past investments.

With passenger recovery underway now that COVID-19-related travel restrictions have been lifted, we see social factors as a moderately negative consideration for our credit analysis, compared with negative previously. Passenger traffic numbers in the second quarter of this year reached close to 80% of 2019 levels. Although we anticipate that the traffic recovery could slow over the strong summer period, we believe macroeconomic headwinds, more than the adverse health and safety measures, will drag on the recovery momentum.

Issue Ratings - Subordination Risk Analysis

Capital structure

Schiphol's capital structure consists primarily of €4.4 billion of senior unsecured notes under its euro medium-term note program, plus unsecured bank loans of about €945.5 million. The group's total gross debt amounted to €5.4 billion as of Dec. 31, 2021.

Analytical conclusions

We rate the unsecured debt issued by Schiphol Group at 'A-', the same as its issuer credit rating, reflecting that priority liabilities in the form of secured loans are significantly less than 50%.

Ratings Score Snapshot

Issuer Credit Rating: A-/Stable/A-2

Business risk: Excellent

- Country risk: Very Low
- Industry risk: Low
- Competitive position: Excellent

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb

- Related government rating: AAA
- Likelihood of government support: Moderately high (+2 notches from SACP)

Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:

- Climate transition risks

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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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, 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

- European Aviation Is Set For A Strong Summer Before Brewing Macro Headwinds Blow In, June 8, 2022
- Royal Schiphol 'A/A-1' Ratings Affirmed On Resilient Ratios Despite Slower Recovery; Outlook Negative, Jan. 28, 2022

Ratings List

Downgraded; Outlook Action

	To	From
Royal Schiphol Group N.V.		
Schiphol Nederland B.V.		
Issuer Credit Rating	A-/Stable/A-2	A/Negative/A-1
Senior Unsecured	A-	A

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on 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; or Stockholm (46) 8-440-5914