Research Update:

Dutch Airport Operator Royal Schiphol Group Downgraded To 'A' On Protracted Traffic-Volume Recovery; Outlook Negative

July 15, 2020

(***Editor's Note:*** *We republished this article on July 22, 2020, to correct the number of notches of uplift we add to Schiphol's SACP for government support, which we misstated in the Government Influence and Ratings Score Snapshot sections. The corrected version follows.)*

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Rating Action Overview

- We expect that global travel restrictions, weak economic conditions, and social-distancing measures related to the COVID-19 pandemic will lead to approximately 65% fewer passengers at Netherlands-based Royal Schiphol Group N.V. (Schiphol) in 2020 than in 2019. This is a steeper reduction than we anticipated, and we now think the recovery to prepandemic levels could take until at least 2024.
- In our view, Schiphol's weighted-average funds from operations (FFO) to debt will decline close to 8% on average over 2021 and 2022, compared with 19.0% in 2019. Despite significant scaling down, Schiphol's capital investment of €3.0 billion over 2020-2024 requires further debt funding.
- The Dutch government's track record of support for its holdings and focus on preserving its holdings' credit quality leads us to reassess the degree of extraordinary state support for Schiphol, from moderate to moderately high.
- We are lowering our long-term issuer credit rating on Schiphol and its core subsidiary Schiphol Netherlands B.V. to 'A' from 'A+', to reflect a two-notch downward revision of its stand-alone credit profile (SACP) to 'bbb+' from 'a+'.
- The negative outlook reflects the risk of a one-in-three chance of a further downgrade of at least one notch if the pandemic's consequences for passenger traffic and retail revenues are worse than we expect, resulting in weighted-average FFO to debt below 8%.

Rating Action Rationale

COVID-19-related global travel restrictions, weak economic conditions, and social-distancing measures will lead to approximately 65% fewer passengers at Schiphol in 2020 than in 2019. We believe that Schiphol's passenger traffic volumes in 2020 might be affected more than those of some global counterparts. This is due to its mainport Amsterdam Airport Schiphol's (Schiphol Airport) very limited share of domestic traffic, which we expect to start picking up earlier than nondomestic traffic, and the future capacity schedules announced by Schiphol's main airline KLM, which accounted for about 50% of passengers in 2019 (see "Airports Face A Long Haul To Recovery," published May 28, 2020). While air travel has started to pick up at Schiphol Airport since the start of July, there are uncertainties as to the timing, pace, and shape of traffic recovery.

Assuming the 2019 level of traffic returns by 2024, and subject to the implementation of mitigating actions, we expect Schiphol's weighted-average FFO to debt will be close to 8% over 2021-2022, down from 19.0% in 2019. We think traffic volumes in 2020 are not representative of the long-term traffic trends for airports. European airports are essential infrastructure assets with a strong market position and often regulated earnings. Therefore, in our ratio calculation, we look beyond the short-term disruption, and place more emphasis on 2021 and 2022.

We forecast that all of Schiphol's revenue streams will suffer over the next two to three years. Compared with 2019, we forecast that Schiphol's total revenues will be 50%-60% lower in 2020, 25% lower in 2021, and about 15%-20% lower in 2022. Aeronautical income will depend on traffic volumes and charges per passenger. We factor into our base case the approved tariff increases of 8.7% for 2020--which came into force with a three-month delay--and 4.2% for 2021. Visibility on regulatory tariffs in the next regulatory period, 2022-2025, is limited; however, Schiphol has a case for higher tariffs to compensate for large investments in the past. In addition, after 2022, Schiphol is entitled to receive settlements for traffic deviations during the 2019-2021 period, net of lower operating costs. We are skeptical about the full recovery of these settlements, in particular if they demand double-digit increases, which could prove difficult for the financially weak airlines.

Nonaeronautical income, which corresponds to about 40% of Schiphol's total in 2019, could also drop due to the possible closure of some retail or food and beverage outlets, and lower consumer spending. Similar to Flughafen Zurich, Schiphol has significant real estate holdings with more than 90% occupancy rate in a normal year. We expect these revenue streams--in particular, renting office space to large multinational companies--to be more stable during the pandemic.

Despite significant scaling down, Schiphol's capital investment of €3.0 billion over 2020-2024 requires further debt funding. Schiphol will proceed with caution in reducing investments, as congestion has historically weighed on operating margins. The new Lelystad Airport, which aims to alleviate congestion by rerouting traffic from mainport Schiphol Airport, is now complete, but its opening has been postponed to November 2021 because of the pandemic.

Otherwise, Schiphol's cost base is largely fixed, with more than one-third of costs attributable to staff. There is some scope to reduce outsourced costs related to cleaning, security, and maintenance, which are partly dependent on volumes. The Dutch government's wage subsidy schemes will alleviate cash leakage in 2020, and Schiphol will look to implement savings in works dependent on traffic volumes. So far, direct state aid is not forthcoming to large airports as they have sufficient liquidity to absorb the near-term losses. That said, the Dutch government's track record of support for its holdings and focus on preserving their credit quality has led us to revise our assessment of the degree of extraordinary state support for Schiphol.

Indirectly, Schiphol has benefited from state aid packages made available to their flagship airline KLM (part of Air France KLM) which accounted for 50% of Schiphol's passengers in 2019.

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The consensus among health experts is that the pandemic may now be at, or near, its peak in some regions but will remain a threat until a vaccine or effective treatment is widely available, which may not occur until the second half of 2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Environmental, social and governance (ESG) factors relevant to the rating action:

- Health and safety management.

Outlook

The negative outlook on Schiphol Group reflects uncertainty over airlines' future capacity and passengers' willingness to travel, combined with weaker economic conditions. These factors drive our assumption of a generally lengthier recovery, which could be further exacerbated by any potential second waves of COVID-19.

In our base case, we expect Schiphol to maintain weighted-average S&P Global Ratings-adjusted FFO to debt close to 8% over 2021-2022.

Downside scenario

We could lower the rating by at least one notch if we expected a further weakening of Schiphol's credit metrics, in particular if Schiphol failed to maintain weighted-average FFO to debt sustainably above 8%. We think this could occur if:

- The economic recovery is slower or more prolonged than we anticipate, or there are long-lasting effects on air travel from the recessionary macroeconomic backdrop; or
- The company does not execute its planned mitigating actions in good time.

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

Upside scenario

We could revise the outlook to stable if traffic starts to recover in a strong and sustainable way, and if the risk of a further spike in infections falls. There could be some rating upside from the potential tariff settlements to compensate for the drop in traffic, although we lack visibility on the overall regulatory package for 2022-2025.

Company Description

Royal Schiphol Group (Schiphol Group) owns and operates the largest of the Dutch airports, Schiphol Airport, the third-largest airport in Europe by number of passengers and cargo volumes, and one of Air France-KLM's major hubs. Schiphol Airport handled 497,000 air transport movements and 71.7 million passengers in 2019, and has a virtual monopoly on air travel originating and ending in the Netherlands. The group is 70% owned by the state of the Netherlands (AAA/Stable/A-1+), 20% by the Municipality of Amsterdam, 2% by the Municipality of Rotterdam, and 8% by Aeroports de Paris. Schiphol has a cross-shareholding and cooperation agreement with Groupe ADP.

Our Base-Case Scenario

Assumptions

- A drop in traffic of about 65% in 2020, as a result of the significant decline in passengers due to lockdown measures in Schiphol's domestic and international markets. We anticipate a protracted rebound in traffic, with passenger numbers remaining about 25% below 2019 levels in 2021, and 18% below 2019 levels in 2022. We do not expect traffic to return to 2019 levels until 2024.
- Negative adjusted EBITDA margins in 2020 because we do not expect cost-cutting measures and government-support initiatives such as wage subsidy schemes to fully offset the decline in revenues, since Schiphol's cost base is largely fixed, with about one-third of costs being staff expenses.
- Total capex of about €1.5 billion for 2020 and 2021 and remaining at about €750 million in the following two years.
- No dividend distributions to the shareholders.

Key metrics

Royal Schiphol Group N.V. Key Metrics

	2019	2020	2021	2022
FFO to debt (%)	19.0	N.M.	4-8	8-12
EBITDA margin (%)	40.7	N.M.	25-30	30-35

N.M.--Not meaningful.

Liquidity

We view Schiphol's liquidity as adequate. We estimate that sources of liquidity in the 12 months to June 30, 2021, will exceed uses by at least 1.2x. 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, including only one equity covenant ratio.

We expect that Schiphol's principal liquidity sources for the 12 months to June 30, 2021, will include:

- Unrestricted cash and cash equivalents of about €516 million;
- Fully available revolving credit lines of €600 million, half of them maturing in June 2022 and the other half in October 2021, as well as €423 million available to draw under loan facilities with multinational institutions; and
- Cash flows from operations of about €100 million.

We expect that principal liquidity uses over the same period will include:

- Debt maturities of about €450 million;
- Capex of about €700 million-€800 million; and
- No dividends.

Government Influence

We add two notches of uplift to Schiphol's SACP to reflect what we see as a moderately high likelihood of timely and sufficient extraordinary support by the Dutch government, based on our assessment of Schiphol's:

- Important role, owing to the essential infrastructure nature of the group's main asset, Schiphol Airport, 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; and
- Strong link with the Dutch government. We revised the link from limited previously as we believe the ownership structure is relatively stable and the Dutch government has sufficient oversight of Schiphol's activities. Although Schiphol is managed as a stand-alone entity with limited government interference, the government has a track record of support for its holdings and a focus on preserving their credit quality at a minimum 'A-' rating level.

Issue Ratings - Subordination Risk Analysis

Capital structure

Schiphol Group's capital structure consists primarily of €1.9 billion of senior unsecured notes under its euro medium-term note program, plus unsecured bank loans of €554 million issued by the European Investment Bank (EIB). The group's total gross debt stands at €2.8 billion as of Dec. 31, 2019.

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/Negative/A-1

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)
- Financial policy: Neutral
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 impact)
- Stand-alone credit profile (SACP): bbb+
- Related government rating: AAA

Likelihood of government support: Moderately high (+2 notches from SACP)

Related Criteria

- 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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Industrials: Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, 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

Related Research

- Rating Actions Taken On Seven European Airports Due To More Protracted Passenger Recovery, July 14, 2020