

RatingsDirect®

Research Update:

Royal Schiphol Group N.V. 'A+/A-1' Ratings Affirmed On Financial Capacity; Outlook Stable

Primary Credit Analyst:

Juliana C Gallo, London (44) 20-7176-3612; juliana.gallo@spglobal.com

Secondary Contact:

Beata Sperling-Tyler, London (44) 20-7176-3687; beata.sperling-tyler@spglobal.com

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria

Ratings List

Research Update:

Royal Schiphol Group N.V. 'A+/A-1' Ratings Affirmed On Financial Capacity; Outlook Stable

Overview

- Royal Schiphol Group N.V. (Schiphol Group) is undergoing a peak investment phase in order to accommodate an increasing number of passengers.
- Despite the lower ratios on the back of investments and higher shareholder returns, we think Schiphol Group has sufficient financial capacity to meet its plan without impairing its financial risk profile in the next few years.
- We are therefore affirming our 'A+/A-1' ratings on Schiphol Group.
- The stable outlook reflects our view that Schiphol Group will maintain good operating performance and will be able to manage its capital expenditure program while maintaining sufficient headroom in its ratios.

Rating Action

On Aug. 22, 2017, S&P Global Ratings affirmed its 'A+' long-term and 'A-1' short-term corporate credit ratings on Dutch airport operator Royal Schiphol Group N.V. (Schiphol Group). The outlook is stable.

At the same time, we affirmed our 'A+' long-term rating on Schiphol Group's senior unsecured debt.

Rationale

The affirmation reflects our view that Schiphol Group has the financial capacity to increase leverage to meet its objectives in terms of shareholder returns and peak investments, as demonstrated by its solid operating cash flow and strong balance sheet. The group is scaling up its capital expenditure (capex) program to secure sufficient airport capacity to support further sustainable traffic growth, while being subject to capacity and environmental constraints. Although these factors weigh on our view of the airport's strong competitive position, the company has developed a master plan to address them over the next 10 years by expanding in particular terminal and pier capacity. We expect the group's annual capex to almost double from the current levels of about €300 million-€400 million to about €600 million per year. In addition, the dividend payout ratio of 60% could further erode the headroom in our forecast ratios.

In our base-case scenario, funds from operations (FFO) to debt will likely decline to 18%-20% over the next three years, from 24.6% delivered in 2016,

but will continue to have significant headroom compared with our rating trigger of 13%. We have assumed a decrease in aviation charges of 7.1% applied in April 2017, mitigated by our expectations of high-single-digit passenger growth for the year. Netting the two effects, we expect that Schiphol Group will be able to maintain its adjusted EBITDA margin of about 40%. The airport group's earnings are more volatile than those of peers, owing to several reductions in airport charges that have been driven by high passenger volume and low weighted-average cost of capital (23% cumulative decline in airport charges between 2015-2017). Because of the group's substantial investment projects, we expect airport charges to rise starting in 2018. In our view, Amsterdam's Schiphol Airport has the room to increase tariffs, given that its airport charges are among the lowest in Europe. This will continue benefiting the group's competitiveness against other hub airports in Europe; only two competitive hub airports (Dubai and Istanbul) offer lower charges.

We expect passenger numbers to continue growing, causing increased pressure on existing infrastructure and terminal capacity, which we think will lead to congestion in the terminal complex at peak times. We understand that the airport is technically capable of accommodating volumes in excess of this figure; however, this could negatively affect the quality of service provided to passengers and shift demand to other less-congested airports. This peak in investments could also have a knock-on effect on efficiency and cost management. Operating expenses rose by nearly 5% in 2016 while revenues increased by only 0.8%.

After several years of significant traffic growth, Schiphol handled more passengers than the estimated maximum terminal capacity. In 2016 Schiphol Airport ranked third in Europe in terms of passenger numbers, with a total of 63.6 million passengers against 58 million in 2015 (+9%). The traffic growth has continued on the high upward trend; the first six months in 2017 registered 8.7% growth compared with 2016. Nevertheless, from 2018, Schiphol Airport is expected to deliver traffic volumes below the growth trend as seen in the past, as the airport's maximum capacity of 500,000 aircraft is hampering future growth and, hence, lowering our passenger growth assumptions until 2020.

Our assessment of Schiphol Group's business risk profile continues to reflect its dominant market position within its wealthy and large catchment area. The group benefits from one of the strongest and wealthiest overall catchment areas with 35 million people living within 200 kilometers of the airport.

The group has a track record of managing its cost base in tough economic conditions and enjoys a supportive regulatory framework, which allows it to adjust tariffs in response to cost pressures.

However, these positive factors are partly offset by Schiphol Group's dependence on its main client, Air France KLM (not rated), as well as a high share of transfer passengers. Transfer traffic represented about 37.8% of total passenger volume in 2016 and exposes the company to greater competition from other European hubs, such as London Heathrow and Paris Charles De Gaulle.

In our opinion, transfer passengers are more exposed than origin/destination passengers to the competitiveness of Air France KLM.

Schiphol Group also faces environmental constraints. Schiphol Airport's existing runway system has the physical capacity to handle around 600,000 air traffic movements (ATMs) a year--well in excess of the total number of ATMs handled in 2016 (478,864). Schiphol Airport is also subject to noise regulations that limits the number of ATMs to 500,000 until 2020. As a result, this could also add challenges to the group's future growth.

On July 1, 2017, an amendment to the Aviation Act entered into force. The Aviation Act lays down the terms of the operating license of Schiphol Airport. In addition, the Aviation Act regulates the manner in which Schiphol Group may set the aviation charges, as well as the level of these charges. Among of other things, one of the most important changes under the amendment is that charges will no longer be fixed annually, but rather every three years, starting with the 2019-2021 period. To offset the risks associated with setting charges for a longer period, Schiphol Group will be allowed to revisit charges from the agreed levels if security measures need to be implemented outside the agreement or if there is a divergence in actual traffic volumes from planned volumes, in which case the difference will be reflected in the revenue allowance for the three subsequent years. In our view, the regulation remains transparent and predictable.

In our base case for Schiphol Group, we assume:

- Flat annual GDP growth in Netherlands of about 2.2% in 2017 and 1.9% in 2018, as well as modest growth in eurozone GDP of about 2.0% in 2017 and 1.7% in 2018.
- Annual passenger volume growth for Schiphol Airport of about 7% in 2017, which is lower than 9% achieved in 2016. We typically see numbers of passengers at the airport and their retail spending growing at 1.5x-2.0x GDP. That said, traffic statistics for the first six months of 2017 already indicate a solid upward trend for 2017, with passenger numbers exhibiting high-single-digit growth.
- We foresee an annual passenger growth of 1.7%-1.8% in 2018 and 2019, in line with European GDP growth and much lower than in the previous years. Indeed, airport charges are expected to rise starting in 2018 due to substantial investment projects, which will have an impact on the number of passengers. In addition, the airport is reaching its full capacity.
- Aviation revenues in 2017 should benefit from strong passenger levels, but should be somewhat affected by the impact of the 7.1% cut in airport charges, implemented in April 2017. Therefore, we expect aviation revenues to slightly decrease by around 1%.
- We expect modest growth in non-aviation revenues over the next two years. Retail is increasingly hampered by crowded lounges and limited (commercial) floor space. Parking revenue growth is slowed by lower-margin online bookings. On a like-for-like basis, we expect the real estate revenue to remain largely unchanged. We expect total rental space available to increase by 2% annually. Occupancy rates are expected to be stable.

- The reported EBITDA margin will remain around 40% over 2017-2019.
- Increasing capex to an annual average of €600 million in 2017-2019 for the expansion and upgrade of existing airport infrastructure.
- Dividends assumed at 55% (the midpoint of the group's new revised policy of 60% of the previous year's net income), which we understand the company would have flexibility to manage in case of a stress situation.

Based on these assumptions, we arrive at the following credit measures:

- A weighted average ratio of S&P Global Ratings-adjusted FFO to debt of about 18%-20% in 2017-2019, which compares with about 24% in 2016.
- A weighted average ratio of adjusted debt to EBITDA of 3.7x-4.2x in 2017-2019, which compares with about 3.1x in 2016.

We add one notch of uplift to Schiphol Group's stand-alone credit profile (SACP) to reflect what we see as a moderate likelihood of timely and sufficient extraordinary support by the Dutch government.

Our view of a moderate likelihood of government support is based on our assessment of Schiphol Group's:

- Important role, based on our view on 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
- Limited link with the Dutch government. In our view, Schiphol Group is managed as a stand-alone entity with limited government interference. Its directors are appointed by a supervisory board that is not controlled by government-linked members. The Dutch government also has a limited track record of supporting entities of this nature.

Liquidity

We consider Schiphol Group's liquidity as strong, mainly deriving from ample liquidity sources on hand (such as the undrawn long-term revolving credit facility [RCF] and available cash holdings), its ability to generate solid operating cash flows, and its demonstrated access to debt markets. These sources compare favorably with liquidity uses, in particular high capex. We expect liquidity sources to cover uses by at least 1.5x over the next year and more than 1.0x over the following year.

We estimate liquidity sources for the 12 months started June 30, 2017, to mainly include:

- Projected cash and cash equivalents of about €155 million-€175 million.
- Full availability under the RCF of €575 million.
- Projected FFO of €460 million-€470 million.

We estimate liquidity uses for the 12 months from June 30, 2017, to mainly include:

- Debt maturities of about €37 million.
- Projected capex of about €600 million.

- Dividends of about €145 million.

The loan agreements with the European Investment Bank include an "own funds to total assets" covenant calculated as equity as a percent of the total balance sheet. This ratio is tested annually and should be higher than 30%.

Outlook

The stable outlook reflects our view that Schiphol Group will be able to maintain its position operating the primary airport in its region, and demonstrate stable and strong growth in passenger volumes. Despite the mild revenue increase resulting from tariff reductions, we foresee Schiphol Group maintaining its profitability margins, thanks to its efforts to control operating expenses. Furthermore, the stable outlook reflects that on sovereign rating on The Netherlands, as the rating on Schiphol Group benefits from one notch of uplift due to our assessment of the likelihood of extraordinary government support. In our base case, we expect Schiphol Group will achieve adjusted FFO-to-debt ratios of 18%-20%, which we think will provide sufficient headroom while the group undertakes its significantly higher capex program to address future traffic growth.

Downside scenario

We could take a negative rating action if Schiphol Group's competitive position weakened. Such weakening could be indicated, among others, by more-volatile-than-expected profitability and EBITDA generation--for reasons other than a traffic- or cost base-driven reset in regulated tariffs--which could stem, for example, from stronger competition from other airports or additional expenses to manage terminal capacity constraints triggering significant volatility to its EBITDA. We could also take a negative rating action if the group's credit metrics were to weaken, specifically if FFO to debt declined to below 13%, due to increased leverage to finance investments and dividends.

Upside scenario

In our view, an upgrade is unlikely at this stage. We believe that the shareholders would ask Schiphol Group to pay additional dividend and that airport charges would fall if the group's credit metrics improved such that we could revise up our assessment of its SACP. Furthermore, we expect that the airport will continue to face capacity constraints in the coming years, which will incur important capex and operating expenditures and result in negative cash flow generation. We could potentially take a positive rating action if the group's FFO to debt sustainably exceeds 20%, all else being equal, and in particular if our views of the group's business position and profitability remain unchanged. This would also be bolstered by a more moderate investment phase and a continued supportive shareholder policy.

Ratings Score Snapshot

Corporate Credit Rating: A+/Stable/A-1

Business risk: Excellent

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

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: a

Modifiers

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

Stand-alone credit profile: a

- Sovereign rating: AAA
- Likelihood of government support: Moderate (+1 notch from SACP)

Related Criteria

- 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: 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: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed

Royal Schiphol Group N.V.

Corporate Credit Rating	A+/Stable/A-1
Senior Unsecured	A+

Schiphol Nederland B.V.

Corporate Credit Rating	A+/Stable/A-1
Senior Unsecured	A+

Additional Contact:

Industrial Ratings Europe; Corporate_Admin_London@spglobal.com

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. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the 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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Copyright © 2017 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.