

## Wellington International Airport Ltd.

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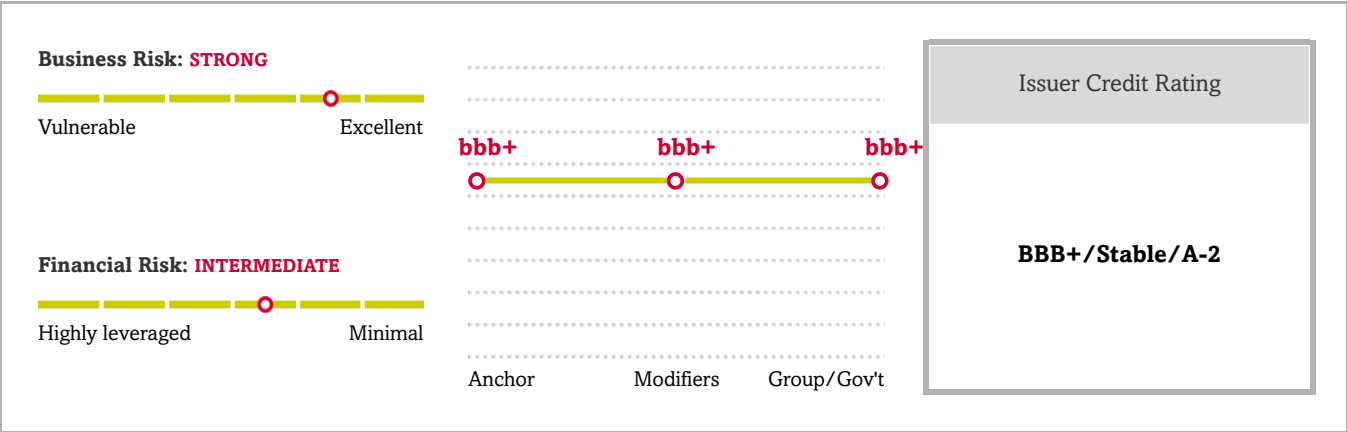
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# Wellington International Airport Ltd.



## Rationale

Business Risk: Strong	Financial Risk: Intermediate
<ul style="list-style-type: none"> <li>Stable passenger base serving New Zealand's capital city and second-largest urban area</li> <li>Lower revenue diversity compared with peers' due to its relatively small landholding</li> <li>Potential for direct long-haul flights through runway extension project</li> </ul>	<ul style="list-style-type: none"> <li>Stable operating metrics generating steady FFO</li> <li>Debt funding for ongoing commercial and property investment reducing FFO to debt to around 13%</li> <li>Uncertainty regarding the capital requirement and timing of runway development</li> </ul>

## Outlook: Stable

The stable outlook on Wellington International Airport Ltd. (WIAL) reflects our view that the airport's overall passenger growth will remain broadly stable, at about 1.5% over the next one to two years. The outlook also reflects our view that the company will, if required, manage its balance sheet in order to maintain its key financial metrics of funds from operations (FFO) to debt and FFO interest coverage at or above 13% and 3.5x respectively, over the next two years.

### Downside scenario

The rating could be at risk if we were to expect the airport's FFO-to-debt ratio to sustainably fall to less than 13%. This scenario would most likely occur because of continued high capital investment combined with earnings pressure due to weak traffic growth.

### Upside scenario

Given the step-up in capital investment over the next 12 months, we view a higher rating as unlikely. In any event, a rating uplift could occur if the ratio of FFO to debt were to remain at more than 18%, and we believe the company would be willing to support such a level.

## Our Base-Case Scenario

Assumptions	Key Metrics			
<ul style="list-style-type: none"> <li>Total traffic growth to remain around 1.5% over the next two years, with modest growth in domestic passengers and about a 2%-4% increase in international passengers. This is supported by our forecast GDP growth of around 2.1%-2.3%.</li> <li>Revenue growth to be strong over the next two years at 5%-10%, supported by revenues from the airport's multilevel car park and hotel.</li> <li>Operating expenses to also increase with these projects coming online, leading to an EBITDA margin of 73%-75%.</li> <li>Ongoing aeronautical, commercial and property investments to drive high capital expenditure at NZ\$60 million-NZ\$90 million per year, with some flexibility on timing.</li> <li>All-in interest costs to remain at around 4.5%.</li> <li>Dividends, after adjustments for subvention payments, to be about NZ\$40 million per year.</li> </ul>	Year end March 31	2018A	2019E	2020E
	EBITDA margin (%)	74.9	74-76	73-75
	FFO to debt (%)	14.0	12.5-14.5	13-15
	FFO cash interest coverage (x)	4.4	4.0-4.4	4.0-4.4
A--Actual. E—Estimate. FFO—Funds from operations.				

## Company Description

Wellington International Airport Ltd. owns and operates Wellington Airport, the third-largest airport in New Zealand. The airport benefits from its location that services New Zealand's capital city and received about 6.15 million passengers in the fiscal year ended March 31, 2018. The airport is 34% owned by Wellington City Council (AA/Stable) and the remainder by NZ Airports Ltd., a wholly owned subsidiary of Infratil Ltd., a New Zealand-based infrastructure fund.

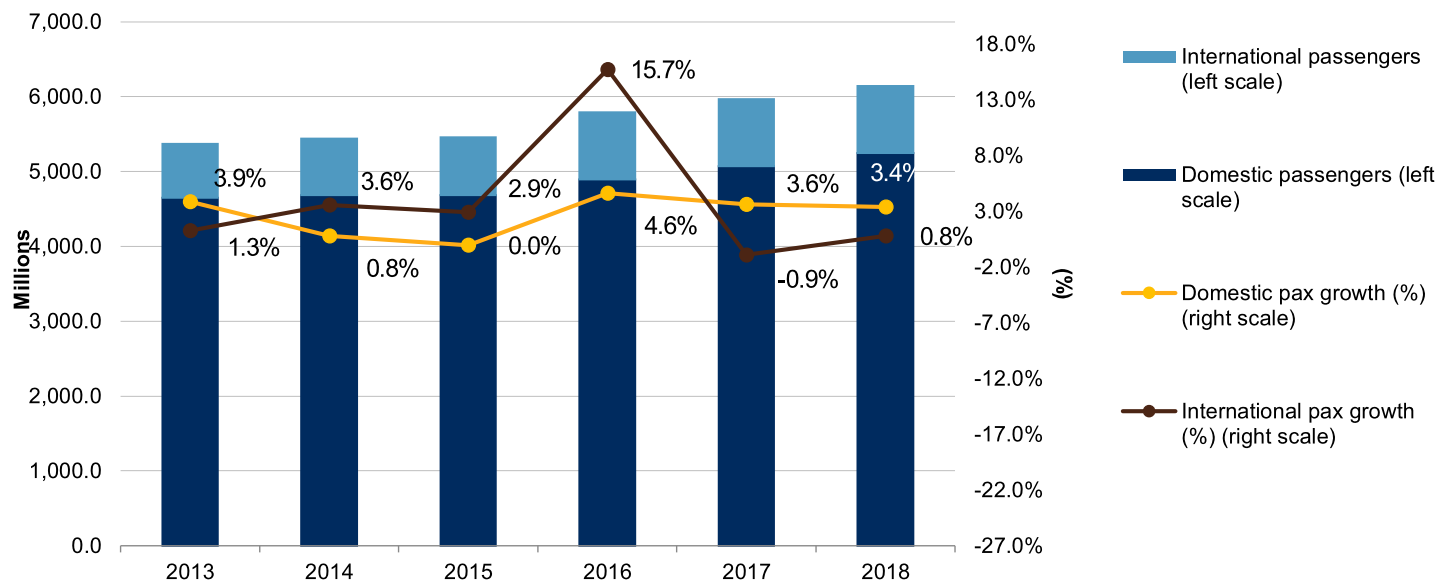
## Business Risk: Strong

The airport has a strong position as the gateway to the country's second-largest urban area. Wellington is also the seat of the central government and headquarters for large corporations in New Zealand's capital city.

Given WIAL's location, we expect the airport's more stable passenger growth trends compared with other New Zealand airports to continue for the foreseeable future. Supporting this stability is the large portion of business-related or VFR (visiting friends and family) traffic, with lower exposure to international tourism. On the other hand, Wellington has not benefitted from the strong growth in international traffic to the same extent that some of its peers have experienced, and as a result, has a relatively low proportion of international traffic.

Chart 1

## Wellington International Airport's Passenger Growth Trends



Source: Company's data.

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WIAL is dependent on domestic traffic, which comprises about 85% of the airport's passenger numbers. International traffic is limited mainly due to runway constraints, which restrict international routes to connections via Australia or the South Pacific. As such, growth in international traffic remained flat in fiscal 2018, with the benefit of the new Wellington-Canberra-Singapore route partially offset by the withdrawal of Jetstar Airways' service to Melbourne.

However, international demand has increased during the first four months of fiscal 2019, and is likely to grow at the low-to-mid single digit rate over the medium term. Supporting this growth is the withdrawal of the alliance between Air New Zealand and Virgin Airlines, increasing competition and capacity, and the introduction of more seasonal capacity. Given the low international traffic base, new routes can boost growth by solid percentage rates followed by periods of flat growth if no new routes are added.

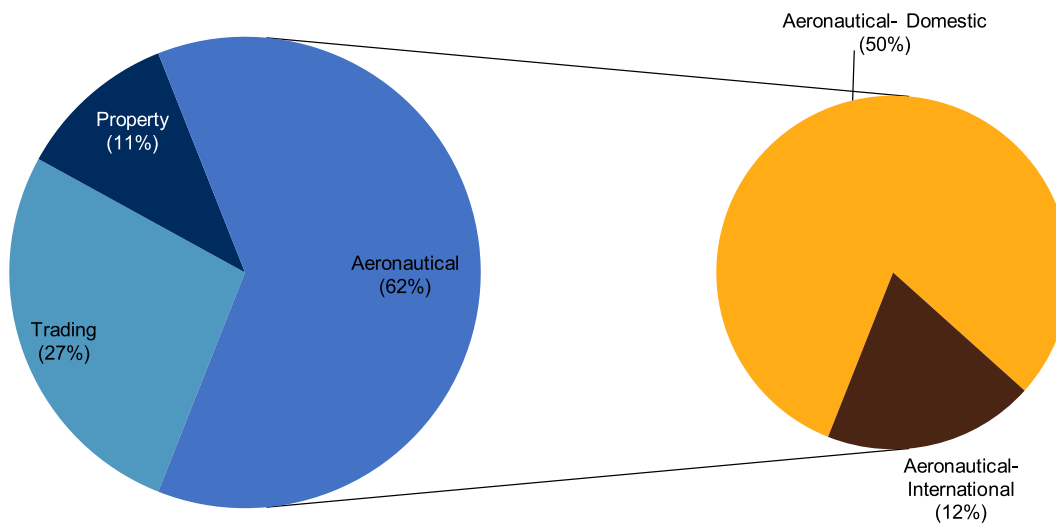
WIAL, similar to its peers, benefits from the light-handed regulatory regime for airports in New Zealand. The current aeronautical pricing is set until March 2019, and has been extended for a further six months pending the airport's master capital expenditure plans. At the current level of interest rates and consequent decline in the weighted average cost of capital, the phasing of capital expenditure would be an important input for determining the next five-year aeronautical charges. The capital expenditure could likely lead to flat or a slight decline in airline tariffs initially, with a combination of passenger growth and indexation offsetting any reduction in aeronautical revenues in the subsequent years.

Somewhat weakening WIAL's strong business position is the airport's lower revenue diversity compared with regional peers', and some operational constraints. WIAL's property investment opportunities are limited by its relatively small landbank. That said, it is in the final stages of completing a new multilevel car park and four-star 134-room hotel complex due to open by the end of 2018. These investments will slightly improve its property revenues. By way of comparison, airports like Auckland and Christchurch have invested heavily in recent years in commercial and industrial buildings to respond to demand, boosting their revenues in that segment.

## Chart 2

### Wellington International Airport's Revenue Breakdown

Fiscal year ended March 31, 2018



Source: Company's data.

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WIAL also faces operational constraints due to its smaller runway length, limiting its ability to handle wide-body long-haul aircrafts. WIAL has re-submitted its application to the Civil Aviation Authority for extending the runway, based on the Supreme Court's guidance on the required length of the end safety areas. A decision is expected later this year.

Based on WIAL's business case for the runway, and subject to obtaining the necessary consents, WIAL will require additional external funding, such as from local and/or central governments in order to proceed with the runway extension. At this stage, we do not make any provision for the expenditure linked to the airport's runway extension in our base case.

## Peer comparison

We consider WIAL's closest peers to be other rated airports in Australia, including Perth, Brisbane, and Adelaide airports, and in New Zealand, including Christchurch and Auckland airports. All airports except Auckland have similar business risk profiles to Wellington.

Perth Airport continues to be exposed to a weaker Western Australian economy. Auckland Airport has a stronger business risk profile because it is the main international gateway to New Zealand. The Australian airports also benefit from a light-handed regulatory regime that enables them to independently set tariffs in agreement with the airlines. The main New Zealand airports may set airline prices in accordance with the Airline Authorities Act and must also disclose their performance under an information disclosure regime.

Christchurch International Airport continues to perform strongly on the back of the attractiveness of the region to Asian travelers, along with Auckland International Airport. However, due to its dominant competitive position, Auckland continues to capture a growing share of the international market in comparison to Christchurch and Wellington, supported by its large size and coverage of the largest populated area.

Wellington International Airport has a stronger financial profile than the three Australian peers because of the former's less leveraged capital structure. The rating on Christchurch Airport also reflects the potential for extraordinary support from its 75% shareholder, Christchurch City Holdings Ltd.

**Table 1**

Wellington International Airport Ltd. -- Peer Comparison						
Industry Sector: Infrastructure						
	Wellington International Airport Ltd.	Perth Airport Pty Ltd.	Brisbane Airport Corp. Pty Ltd.	Adelaide Airport Ltd.	Christchurch International Airport Ltd.	Auckland International Airport Ltd.
	--Average of past three fiscal years--					
(Mil. NZ\$)						
Revenues	120.6	538.6	691.3	212.5	176.6	627.0
EBITDA	91.3	355.4	511.3	130.9	108.1	486.1
Funds from operations (FFO)	53.6	240.8	302.2	77.8	70.5	315.4
Net income from cont. oper.	17.8	106.2	176.2	44.1	65.5	415.1
Cash flow from operations	89.2	215.1	310.4	73.6	68.5	308.7
Capital expenditures	73.4	120.4	297.4	37.5	76.8	314.9
Free operating cash flow	15.7	94.7	13.0	36.2	(8.3)	(6.2)
Discretionary cash flow	(20.5)	(119.1)	(43.8)	(31.4)	(42.2)	(205.2)
Cash and short-term investments	31.8	17.2	50.4	69.7	2.1	68.1
Debt	354.9	2,199.5	2,588.1	699.1	367.0	1,833.3
Equity	534.9	779.2	1,936.3	258.1	880.5	4,530.6

Table 1

## Wellington International Airport Ltd. -- Peer Comparison (cont.)

Industry Sector: Infrastructure						
	Wellington International Airport Ltd.	Perth Airport Pty Ltd.	Brisbane Airport Corp. Pty Ltd.	Adelaide Airport Ltd.	Christchurch International Airport Ltd.	Auckland International Airport Ltd.
<b>Adjusted ratios</b>						
EBITDA margin (%)	75.7	66.0	74.0	61.6	61.2	77.5
Return on capital (%)	7.9	8.1	8.1	10.2	5.6	8.3
EBITDA interest coverage (x)	4.0	3.3	2.9	3.0	5.0	5.8
FFO cash int. cov. (X)	4.1	3.1	2.6	2.8	4.3	4.7
Debt/EBITDA (x)	3.9	6.2	5.1	5.3	3.4	3.8
FFO/debt (%)	15.1	10.9	11.7	11.1	19.2	17.2
Cash flow from operations/debt (%)	25.1	9.8	12.0	10.5	18.7	16.8
Free operating cash flow/debt (%)	4.4	4.3	0.5	5.2	(2.3)	(0.3)
Discretionary cash flow/debt (%)	(5.8)	(5.4)	(1.7)	(4.5)	(11.5)	(11.2)

## Financial Risk: Intermediate

We expect WIAL's financial metrics to worsen because of its capital investment. Underpinning the financial risk profile, however, is our expectation that the airport will maintain its FFO-to-debt ratio above 13%.

The airport's capital spending should remain high in the medium term. This includes the ongoing construction of the multilevel car park and hotel scheduled for completion in fiscal 2019. Future projects include the baggage handling system replacement, breakwater upgrades, and other runway and terminal side optimizations, which would keep capital spending at about NZ\$60 million-NZ\$90 million per year over the next two to three years. We expect the airport's FFO-to-debt ratio to hover around 13% during this high capital-spending phase.

Over this period, we expect revenues and EBITDA to grow, driven by a combination of steady tariff growth and income from the new car park and hotel. Furthermore, WIAL would manage any impact of the next airline tariff reset through flexibility on its capital expenditure program and dividend flows, so as to maintain the cash flow leverage metrics above 13%.

## Financial summary

Table 2

## Wellington International Airport Ltd. -- Financial Summary

Industry Sector: Infrastructure					
	--Fiscal year ended Mar. 31--				
(Mil. NZ\$)	2018	2017	2016	2015	2014
Revenues	128.6	119.6	113.5	108.3	110.9
EBITDA	96.3	90.7	86.8	82.9	87.0



Table 2

## Wellington International Airport Ltd. -- Financial Summary (cont.)

Industry Sector: Infrastructure					
(Mil. NZ\$)	--Fiscal year ended Mar. 31--				
	2018	2017	2016	2015	2014
Funds from operations (FFO)	57.6	51.8	51.5	50.4	52.0
Net income from continuing operations	24.7	16.1	12.5	9.7	23.5
Cash flow from operations	94.6	87.6	85.3	81.8	79.8
Capital expenditures	84.5	80.5	55.4	21.6	19.8
Free operating cash flow	10.1	7.1	29.9	60.2	60.0
Dividends paid	35.1	35.5	38.1	35.2	31.8
Discretionary cash flow	(25.0)	(28.3)	(8.2)	25.0	28.2
Debt	412.2	356.4	296.1	263.3	258.7
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	585.3	512.9	506.6	438.1	440.3
Debt and equity	997.5	869.3	802.8	701.4	699.0
<b>Adjusted ratios</b>					
EBITDA margin (%)	74.9	75.9	76.5	76.5	78.4
EBITDA interest coverage (x)	4.1	3.6	4.4	4.3	4.2
FFO cash int. cov. (x)	4.4	3.5	4.4	3.9	3.5
Debt/EBITDA (x)	4.3	3.9	3.4	3.2	3.0
FFO/debt (%)	14.0	14.5	17.4	19.1	20.1
Cash flow from operations/debt (%)	22.9	24.6	28.8	31.1	30.9
Free operating cash flow/debt (%)	2.5	2.0	10.1	22.9	23.2
Discretionary cash flow/debt (%)	(6.1)	(8.0)	(2.8)	9.5	10.9
Net Cash Flow / Capex (%)	26.6	20.3	24.2	70.5	101.9
Return on capital (%)	8.0	7.4	8.4	8.4	9.2
Return on common equity (%)	4.5	3.2	2.7	2.2	5.4
Common dividend payout ratio (un-adj.) (%)	48.4	74.9	103.4	123.7	46.2

## Liquidity: Adequate

The short-term rating on WIAL is 'A-2', which reflects the long-term issuer credit rating and our view of the airport's adequate liquidity. We expect WIAL's sources of liquidity to exceed estimated uses by 1.2x over the next 12 months, and sources to remain above uses, even if WIAL's EBITDA were to drop by 15%.

In our view, WIAL has strong relationships with its banking syndicate and a prudent risk management framework. WIAL refinanced NZ\$100 million of bank debt in January 2018, extending the maturity out by one to four years. We also expect the airport to refinance its existing commercial paper and debt maturities well before the due date of early 2019.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> <li>• Cash and undrawn bank line of about NZ\$110 million as of June 30, 2018.</li> <li>• Cash FFO of about NZ\$70 million over the next 12 months.</li> </ul>	<ul style="list-style-type: none"> <li>• Debt maturities of NZ\$50 million over the next six months from June 30, 2018.</li> <li>• Capital expenditure of about NZ\$60 million-NZ\$80 million over the next 12 months, with some flexibility on the quantum and timing.</li> <li>• Dividend (adjusted for subvention payments) of about NZ\$40 million over the next 12 months.</li> </ul>

### Debt maturities

Year end March 31	Amount (mil. NZ\$)
2019	50
2020	25
2021	25
2022	75
2023	0
Thereafter	305

## Covenant Analysis

WIAL's debt facilities are subject to covenants, which include maintaining its EBITDA interest coverage above 1.8x and debt-to-capital ratio below 60%. We forecast that the company will continue to maintain significant headroom against those levels.

## Ratings Score Snapshot

### Issuer Credit Rating

BBB+/Stable/A-2

### Business risk: Strong

- **Country risk:** Low
- **Industry risk:** Low
- **Competitive position:** Strong

### Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bbb+

## Modifiers

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

## Issue Ratings--Subordination Risk Analysis

### Capital structure

WIAL's capital structure mainly comprises senior unsecured wholesale and retail bonds of NZ\$330 million issued in New Zealand dollars, a senior unsecured US\$72 million U.S. private placement issuance, and bank facilities of NZ\$100 million.

### Analytical conclusions

We rate WIAL's senior unsecured bonds at 'BBB+' in line with the issuer credit rating because no element of subordination risk is present in the capital structure.

## Reconciliation

**Table 3**

### Reconciliation Of Wellington International Airport Ltd. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. NZ\$)

--Fiscal year ended Mar. 31, 2018--

#### Wellington International Airport Ltd. reported amounts

	Debt	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Dividends paid
Reported	421.6	57.5	45.4	19.3	57.5	41.3	11.9
<b>Standard &amp; Poor's adjustments</b>							
Interest expense (reported)	--	--	--	--	(19.3)	--	--
Interest income (reported)	--	--	--	--	0.9	--	--
Current tax expense (reported)	--	--	--	--	(1.2)	--	--
Operating leases	4.1	0.9	0.3	0.3	0.6	0.6	--
Surplus cash	(21.5)	--	--	--	--	--	--
Capitalized interest	--	--	--	4.1	(4.1)	--	--
Non-operating income (expense)	--	--	0.9	--	--	--	--
Debt - Unamortised capitalized borrowing costs	2.9	--	--	--	--	--	--

**Table 3**

<b>Reconciliation Of Wellington International Airport Ltd. Reported Amounts With Standard &amp; Poor's Adjusted Amounts (Mil. NZ\$) (cont.)</b>							
Debt - Foreign currency hedges	5.2	--	--	--	--	--	--
EBITDA - Other	--	37.9	37.9	--	37.9	--	--
FFO - Other	--	--	--	--	(14.8)	--	--
OCF - Taxes	--	--	--	--	--	14.8	--
OCF - Other	--	--	--	--	--	37.9	--
Dividends - Other	--	--	--	--	--	--	23.2
Total adjustments	(9.4)	38.8	39.1	4.4	0.1	53.3	23.2
<b>Standard &amp; Poor's adjusted amounts</b>							
	<b>Debt</b>	<b>EBITDA</b>	<b>EBIT</b>	<b>Interest expense</b>	<b>Funds from operations</b>	<b>Cash flow from operations</b>	<b>Dividends paid</b>
Adjusted	412.2	96.3	84.5	23.7	57.6	94.6	35.1

## Related Criteria

- 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
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, 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: Country Risk Assessment Methodology And Assumptions, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

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**Business And Financial Risk Matrix**

<b>Business Risk Profile</b>	<b>Financial Risk Profile</b>					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+ / a	a-	bbb	bbb-/bb+
<b>Strong</b>	aa/aa-	a+ / a	<b>a-/bbb+</b>	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

**Ratings Detail (As Of October 18, 2018)****Wellington International Airport Ltd.**

Issuer Credit Rating	BBB+/Stable/A-2
Commercial Paper	
Local Currency	A-2
Senior Unsecured	BBB+

**Issuer Credit Ratings History**

13-May-2014	BBB+/Stable/A-2
27-Aug-2012	BBB+/Positive/A-2
17-Dec-2006	BBB+/Stable/A-2

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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