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Wellington International Airport Ltd.

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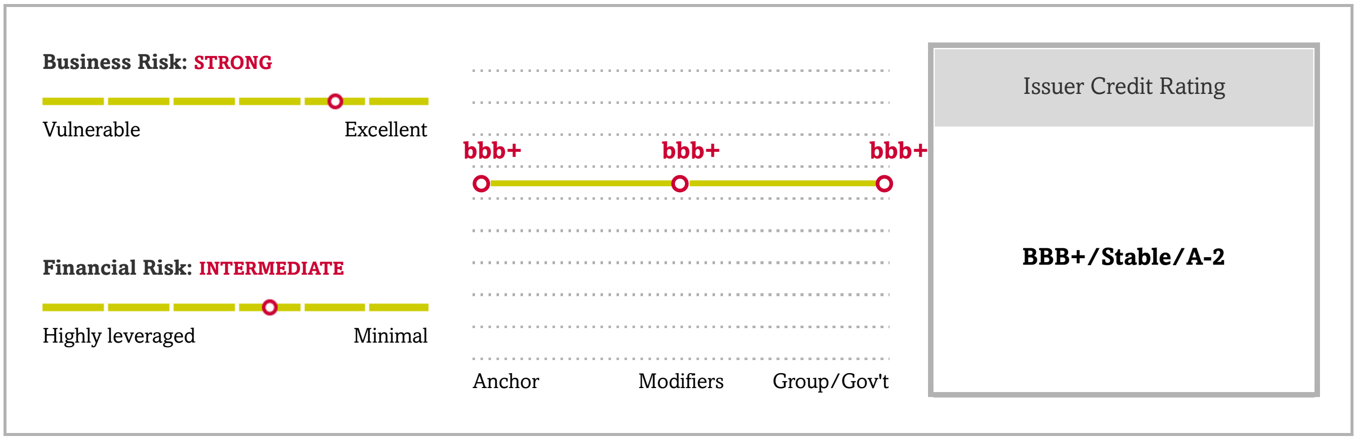
Wellington International Airport Ltd.



Credit Highlights

Overview

Key Strengths	Key Risks
Stable passenger base serving New Zealand's capital city and second-largest urban area	Debt funding for ongoing capex investment reducing FFO to debt to below 13% for a year, before recovering
Revenue diversity, although modest compared with peers' due to its relatively small landholding	Operational/runway constraints to handle long-range large international aircraft that can limit international expansion
Headroom in financial metrics to manage some decline in passenger traffic	Uncertainty regarding the capital requirement and timing of runway development

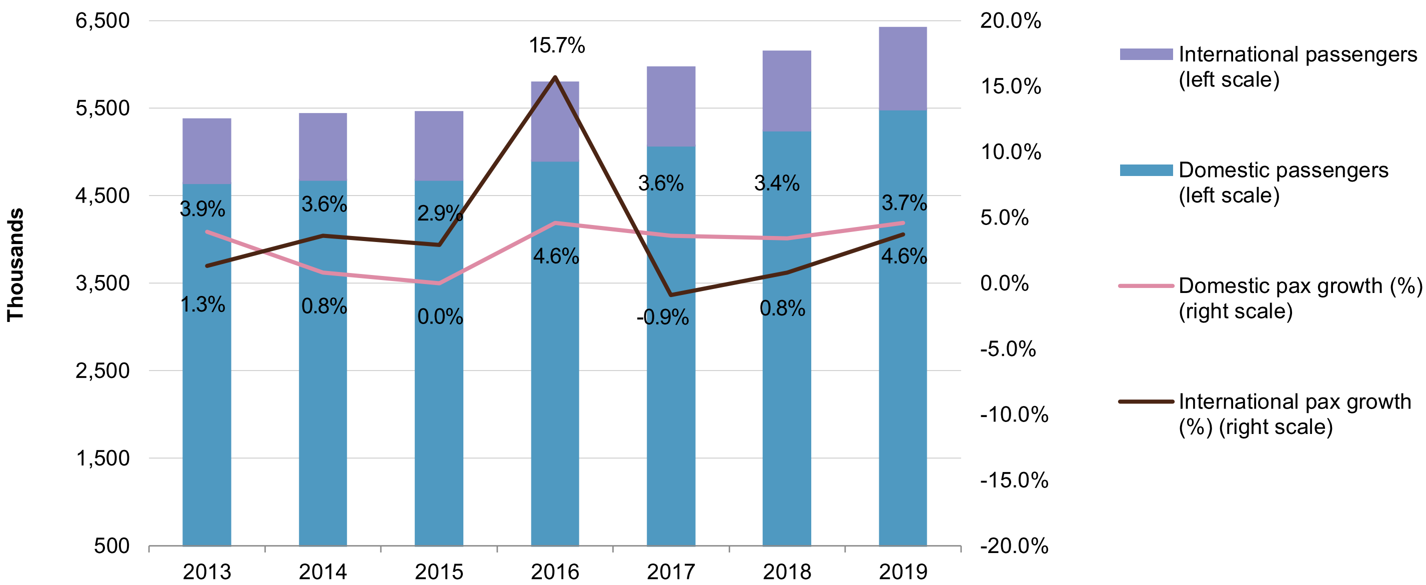
We expect Wellington International Airport Ltd. (WIAL) to maintain its market position supported by passenger growth, despite a potential slowdown. WIAL remains the gateway airport to the country's second-largest urban area. This airport significantly depends on domestic passenger traffic (about 85% of total traffic), which has shown signs of slowing down in recent months. We expect passenger growth to moderate to low single digits over the next two years due to fleet rationalization by two large operators, Air New Zealand and Jetstar Airways; and an economic slowdown.

Price setting for the next five years is likely to be completed by March 2020. The current pricing has been extended as WIAL undertakes completion of its master capital expenditure planning and tariff negotiations with airlines. Given the current low interest rate environment, the amount and schedule of capital expenditure (capex) would be an important input for determining the aeronautical charges for the next five years.

We expect WIAL to maintain its FFO-to-debt metrics above 13%, after a one-off dip. Given the high capital spending in the previous and current fiscal years, WIAL's funds from operations (FFO)-to-debt metrics are likely to fall below the 13% downgrade threshold in the year ending March 31, 2020, before recovering. We believe that WIAL would manage any impact of the next airline tariff reset or sustained decline in passenger growth through its capex program and dividend flows, so as to maintain the cash flow leverage metrics above 13%.

Chart 1

Wellington International Airport's Passenger Growth Trends



Source: Company's data.

Outlook: Stable

The stable outlook on WIAL reflects our view that the airport will be able to withstand a likely moderation in overall passenger growth 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 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 fall to less than 13% on a sustained basis. 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 high 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

- Total traffic growth to remain largely flat at 0%-1% over the next two years, with a slowdown in domestic passengers partially offset by a modest increase in international passengers. This factors in our forecast GDP growth of around 2.7%.
- Revenue growth to be healthy over the next two years, with modest growth in aero revenues bolstered by revenue from the multilevel car park and hotel.
- Operating expenses to increase slightly with implementation of capital projects, leading to an EBITDA margin of 71%-73%.
- Aeronautical, commercial, and property investments to drive high capex at NZ$75 million-NZ$85 million per year, with some flexibility on timing.
- All-in interest costs to remain at around 5% in fiscal 2020, before the benefits of the low interest environment kick in from subsequent years.
- Dividends, after adjustments for subvention payments, to be about NZ$40 million-MZ$50 million per year.

Key Metrics

Year end March 31	2019A	2020E	2021E
EBITDA margin (%)	74.2	71-73	72-74
FFO to debt (%)	14.6	12.5-14.0	13.0-15.0
FFO cash interest coverage (x)	4.5	3.5-4.0	4.3-4.8

A--Actual. E--Estimate. FFO--Funds from operations.

Base-case projections

Slow passenger growth at the time of undertaking the regulatory price setting would be positive for the company. Passenger growth has been low over the past six months. We believe this slowdown would be factored in the regulatory price-setting exercise, which is likely to conclude early next year. Subsequently, WIAL will only be exposed to potential further weakness in passenger numbers.

Flexibility and timing of capex to drive actual FFO-to-debt metrics. Given that the company's capex program consists of multiple projects, the actual timing of implementation may be spread over a couple of years, thereby supporting a higher FFO to debt. The company also retains some flexibility to moderate its spending on certain projects, if passenger growth were to further slow down.

Company Description

WIAL 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 6.4 million passengers in fiscal 2019. The airport is

34% owned by Wellington City Council (AA/Positive/A-1+) and the remainder by NZ Airports Ltd., a wholly owned subsidiary of New Zealand-based infrastructure fund Infratil Ltd.

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 passenger trends to generally remain stable compared with other New Zealand airports. 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 as some of its peers. As a result, Wellington has a relatively low proportion of international traffic.

WIAL is dependent on domestic traffic, which comprises about 85% of the airport's passenger numbers. We expect domestic traffic to decline slightly in fiscal 2020, as large operators Air New Zealand and Jetstar rationalize their fleet. Subsequently, growth is likely to be a modest 1%-2.5% per annum.

International traffic remains limited mainly due to runway constraints, which restrict international routes to connections via Australia or the South Pacific. Nonetheless, international traffic grew by 3.7% in fiscal 2019, supported by higher capacity to the east-coast of Australia. International demand is likely to grow at low-to-mid single digits over the medium term. Given the low base, new routes can boost growth by solid percentage rates followed by periods of flat growth if no new routes are added.

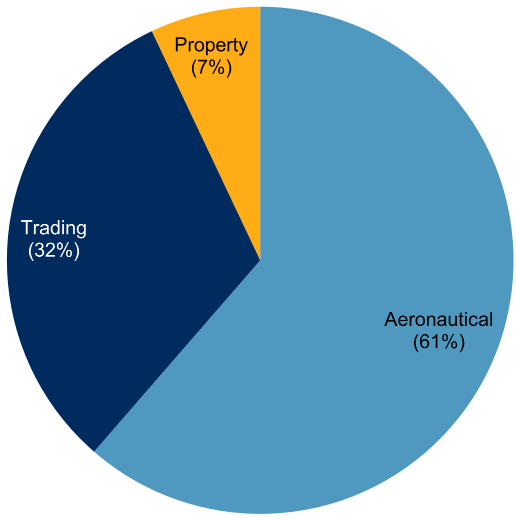
WIAL, similar to its peers, benefits from the light-handed regulatory regime for airports in New Zealand. The current aeronautical pricing expired in March 2019, but has been extended for a further 12 months pending the airport's master capex planning and rate negotiations. Any under and over recovery of revenue is not likely to be material and would largely offset each other once the next pricing period commences. At the current level of interest rates and consequent decline in the weighted average cost of capital, the phasing of capex would be an important input for determining the next five-year aeronautical charges. The capex could 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 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, in 2019 it started operating its new multilevel car park and four-star 134-room hotel complex. These investments will slightly improve its non-aeronautical revenue over the next one to two years as they ramp up. By way of comparison, airports in Auckland and Christchurch have invested heavily in recent years in commercial and industrial buildings to cater to demand, boosting their revenues in that segment.

Chart 2

Wellington International Airport's Revenue Breakdown

Fiscal year ended March 31, 2019



Source: Company's data.

WIAL also faces operational constraints due to its smaller runway length, limiting its ability to handle wide-body long-haul aircrafts. Due to recent changes in safety regulations, WIAL is in the process of re-applying for resource and environmental consent. Based on WIAL's business case, the airport is likely to 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 the 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.
	--Fiscal year ended--					
	March 31, 2019	June 30, 2018	June 30, 2018	June 30, 2018	June 30, 2019	June 30, 2019
(Mil. Mix currency)	NZ$	A$	A$	A$	NZ$	NZ$
Revenue	137.9	522.5	776.5	214.3	187.3	741.6
EBITDA	102.3	352.5	572.1	133.4	125.4	563.1
Funds from operations (FFO)	66.9	190.2	369.1	81.9	84.9	377.6
Interest expense	24.3	103.8	168.5	39.8	23.1	85.5
Cash interest paid	19.4	104.2	160.6	36.5	22.9	84.4
Cash flow from operations	92.4	194.6	339.7	76.0	80.6	378.1
Capital expenditure	72.5	96.9	351.0	42.0	93.2	322.4
Free operating cash flow (FOCF)	19.9	97.8	(11.3)	34.0	(12.5)	55.7
Discretionary cash flow (DCF)	(17.1)	(121.8)	(331.8)	(47.7)	(57.4)	(145.9)
Cash and short-term investments	20.3	11.2	113.1	50.1	0.8	37.3
Debt	458.7	2,076.1	2,531.7	687.1	464.3	1,983.9
Equity	603.7	647.4	1,980.8	249.3	1,052.0	6,032.9
Adjusted ratios						
EBITDA margin (%)	74.2	67.5	73.7	62.3	66.9	75.9
Return on capital (%)	8.1	10.0	10.5	11.9	6.1	9.2
EBITDA interest coverage (x)	4.2	3.4	3.4	3.4	5.4	6.6
FFO cash interest coverage (x)	4.5	2.8	3.3	3.2	4.7	5.5
Debt/EBITDA (x)	4.5	5.9	4.4	5.1	3.7	3.5
FFO/debt (%)	14.6	9.2	14.6	11.9	18.3	19.0
Cash flow from operations/debt (%)	20.1	9.4	13.4	11.1	17.4	19.1
FOCF/debt (%)	4.3	4.7	(0.4)	4.9	(2.7)	2.8

Table 1

Wellington International Airport Ltd.--Peer Comparison (cont.)						
DCF/debt (%)	(3.7)	(5.9)	(13.1)	(6.9)	(12.4)	(7.4)

NZ$--New Zealand dollar.

Financial Risk: Intermediate

We expect WIAL's financial metrics to weaken slightly over the next 12-15 months because of its capital investment. Underpinning the financial risk profile, however, is our expectation that the airport will maintain its FFO-to-debt ratio at above 13% after a one-off dip to below 13% in fiscal 2020.

The airport's capital spending should remain high in the medium term. Over the next one to two years, this includes apron and taxiway development, baggage handling system replacement, breakwater upgrades, and other runway and terminal side optimizations. As a result, capital spending could hover at about NZ$75 million-NZ$85 million for the next two years, before reducing to NZ$30 million-NZ$40 million subsequently.

Over this period, we expect revenues and EBITDA to grow, driven by commercial income including from the new car park and hotel, supported by modest passenger growth. Furthermore, WIAL would manage any impact of the next airline tariff reset through flexibility on its capex 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--				
	2019	**2018**	**2017**	**2016**	**2015**
(Mil. NZ$)					
Revenue	137.9	128.6	119.6	113.5	108.3
EBITDA	102.3	96.3	90.7	86.8	82.9
Funds from operations (FFO)	66.9	62.7	53.3	56.1	49.7
Interest expense	24.3	23.7	25.0	19.7	19.1
Cash interest paid	19.4	18.8	22.0	16.3	18.2
Cash flow from operations	92.4	94.6	87.6	85.3	81.8
Capital expenditure	72.5	84.5	80.5	55.4	21.6
Free operating cash flow (FOCF)	19.9	10.1	7.1	29.9	60.2
Dividends paid	37.1	35.1	35.5	38.1	35.2
Discretionary cash flow (DCF)	(17.1)	(25.0)	(28.3)	(8.2)	25.0
Cash and short-term investments	20.3	21.5	67.8	5.9	22.3
Gross available cash	20.3	21.5	67.8	5.9	22.3
Debt	458.7	409.4	353.9	295.2	262.2
Equity	603.7	585.3	512.9	506.6	438.1
Debt and equity	1,062.4	994.6	866.7	801.9	700.3

Table 2

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

Industry sector: Infrastructure

	--Fiscal year ended Mar. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
Adjusted ratios					
EBITDA margin (%)	74.2	74.9	75.9	76.5	76.5
Return on capital (%)	8.1	9.1	8.4	9.6	9.5
EBITDA interest coverage (x)	4.2	4.1	3.6	4.4	4.3
FFO cash interest coverage (x)	4.5	4.3	3.4	4.4	3.7
Debt/EBITDA (x)	4.5	4.3	3.9	3.4	3.2
FFO/debt (%)	14.6	15.3	15.1	19.0	19.0
Cash flow from operations/debt (%)	20.1	23.1	24.8	28.9	31.2
FOCF/debt (%)	4.3	2.5	2.0	10.1	23.0
DCF/debt (%)	(3.7)	(6.1)	(8.0)	(2.8)	9.5

NZ$--New Zealand dollar.

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. The company maintains commercial paper as part of its capital structure, backed by undrawn bank lines. Also, WIAL continues to maintain sufficient buffer above its interest coverage and leverage covenants.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and undrawn bank line of about NZ$120 million as of June 30, 2019. • Cash FFO of about NZ$65 million (adjusted for subvention payments) over the 12 months ending June 30, 2020.	• Debt maturities of NZ$25 million over the next six months from June 30, 2019. • Capex of about NZ$70 million-NZ$80 million over the next 12 months, with some flexibility on the quantum and timing. • Dividend (adjusted for subvention payments) of about NZ$40 million over the 12 months ending June 30, 2020.

Debt maturities

Table 3

Wellington International Airport Ltd.--Debt Maturities	
Year	**Amount (Mil. NZ$)**
2020	75.0
2021	25.0
2022	75.0
2023	0.0
2024	75.0
Beyond 2024	233.9

NZ$--New Zealand dollar.

Environmental, Social, And Governance

In our view, environment and social factors are neutral to the credit analysis of WIAL.

As an airport operator, WIAL is relatively less exposed to environmental factors, because it is not directly responsible for aircraft-related emissions. WIAL is, however, committed to reducing its own carbon footprint, aiming for a 30% reduction in carbon emissions, electricity use and waste by 2030.

On the social factors, WIAL is responsible for managing and monitoring the effects of airport noise, given its proximity to residential properties. Over many years, the airport has continuously managed this responsibility through projects such as purchasing nearby land assets and installing noise mitigation systems. Charges for these projects are passed on to the airline through monthly landing fees.

We assess the governance factors for the company as neutral, given that we view its governance practices to be consistent with industry peers'.

Issue Ratings - Subordination Risk Analysis

Capital structure

WIAL's capital structure mainly comprises senior unsecured wholesale and retail bonds of NZ$405 million issued in New Zealand dollars, a senior unsecured US$72 million U.S. private placement issuance, commercial paper of NZ$25 million, and bank facilities of NZ$100 million.

Analytical conclusions

We rate NZ$95 million of 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 4

Reconciliation Of Wellington International Airport Ltd. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. NZ$)

	--Fiscal year ended Mar. 31, 2019--						
Wellington International Airport Ltd. reported amounts							
	Debt	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations	Dividends
Reported	480.1	60.9	42.0	19.7	102.3	35.4	12.6
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	--	--	--
Cash taxes paid: Other	--	--	--	--	--	--	--
Cash interest paid	--	--	--	--	(19.1)	--	--
Operating leases	3.2	0.9	0.3	0.3	(0.3)	0.6	--
Accessible cash and liquid investments	(20.3)	--	--	--	--	--	--
Capitalized interest	--	--	--	4.4	--	--	--
Nonoperating income (expense)	--	--	0.3	--	--	--	--
Debt: Foreign currency hedges	(4.3)	--	--	--	--	--	--
EBITDA: Other	--	40.5	40.5	--	--	--	--
Funds from operations: Other	--	--	--	--	(16.0)	--	--
Operating cash flow: Taxes	--	--	--	--	--	16.0	--
Operating cash flow: Other	--	--	--	--	--	40.5	--
Dividends: Other	--	--	--	--	--	--	24.5
Total adjustments	(21.4)	41.3	41.0	4.7	(35.3)	57.1	24.5
S&P Global Ratings' adjusted amounts							
	Debt	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends paid
Adjusted	458.7	102.3	83.0	24.3	66.9	92.4	37.1

NZ$--New Zealand dollar.

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)

Stand-alone credit profile : bbb+

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

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	**a-/bbb+**	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 15, 2019)*

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.