

**Rating Action: Moody's downgrades Heathrow Finance's ratings to Ba2/B1 from Ba1/Ba3; outlook remains negative**

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London, 11 November 2020 -- Moody's Investors Service (Moody's) has today downgraded to Ba2 from Ba1 the corporate family rating (CFR) of Heathrow Finance plc (HF). Concurrently, Moody's also downgraded to Ba3-PD from Ba2-PD the probability of default rating and to B1 from Ba3 the senior secured debt ratings. The outlook on the ratings remains negative. HF, through its shares in Heathrow (SP) Limited (HSP), owns London Heathrow Airport (LHR).

**RATINGS RATIONALE**

The rating downgrade reflects a persistently difficult operating environment for Heathrow airport as evidenced by the weaker than anticipated pace of passenger demand recovery due to travel restrictions and quarantine measures in 2020, and Moody's expectation that the breadth and severity of the coronavirus outbreak will lead to slower than previously anticipated traffic recovery. These dynamics will continue to have a significant detrimental impact on HF's cash flows and, whilst the company is implementing measures aimed at supporting its financial profile, Moody's expects key credit metrics to exhibit a more prolonged weakness than previously anticipated, particularly in respect of Moody's Adjusted Interest Cover Ratio (AICR). The negative outlook continues to reflect the downside risks to HF's credit profile linked to the consequences of the coronavirus outbreak and the significant uncertainties around traffic recovery prospects.

The coronavirus pandemic, the weakened global economic outlook, low oil prices and asset price declines are sustaining a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The airport sector is one of the sectors most significantly affected by the shock given its exposure to travel restrictions and sensitivity to consumer demand and sentiment. Today's action reflects the impact on HF of the breadth and severity of the shock, and the broad deterioration in credit quality it has triggered. Moody's regards the coronavirus outbreak as a social risk under its ESG framework, given the substantial implications for public health and safety.

LHR's traffic has been severely impacted by the pandemic and the introduction of travel restrictions. While flight activity resumed for the peak summer season in July and August, passenger volumes remained subdued, affected by the changing quarantine requirements. In light of the latest government decision to introduce lockdown in England and similar measures implemented in a number of European countries, Moody's estimates that the decline in passenger traffic at LHR will be approximately 75% in the financial year ending December 2020. While Moody's expects passenger volumes to increase in 2021, the timing and profile of any recovery is highly uncertain because (1) LHR exhibits a material exposure to long haul traffic (more than half of the total), as well as business travel, for which recovery is expected to remain weaker and more uncertain than leisure travel, (2) travel restrictions in some form may continue for some time even if the spread of the virus seems contained in some areas; (3) there is evidence of lack of international coordination over travel restrictions and quarantine measures; (4) the deteriorating global economic outlook, as well as the uncertainties linked to Brexit, would likely slow the recovery in traffic and consumer spending, even if travel restrictions are eased; and (5) the coronavirus outbreak is also weakening the credit profile of airlines, which have been drastically cutting capacity. However, Moody's recognises LHR's strong position in the London aviation market and elements of its economic regulation as mitigating factors.

More generally, HF's Ba2 CFR continues to reflect (1) its ownership of LHR, which is one of the world's most important hub airports and the largest European airport and key infrastructure provider, with potential for a strong recovery once the coronavirus outbreak and its effects have been contained, (2) its long established framework of economic regulation, (3) the historically resilient traffic characteristics of LHR, (4) the capacity constraints the airport faced prior to the traffic declines linked to the coronavirus outbreak, (5) the current period of lower capital expenditure levels and its good liquidity profile, (6) an expectation that the HF group will maintain high leverage, and (7) the features of the HSP secured debt financing structure, which puts certain constraints around management activity, together with the protective features of the HF debt, which effectively limit HF's activities to its investment in HSP. HF's B1 senior secured rating reflects the structural subordination of the HF debt in the HF group structure versus the debt at HSP.

## LIQUIDITY AND DEBT COVENANTS

The HF group as a whole exhibits a good liquidity position, allowing for flexibility to cover its expenditure in the context of the significant deterioration in cash flows associated with the significant contraction in traffic. As of the end of Q3 2020, the HF group reported approximately GBP2.4 billion of cash on balance sheet (of which GBP397 million at the level of HF). These amounts exclude the GBP1.4 billion proceeds associated with the recently completed bond issuance at HSP and the planned GBP750 million capital injection into the group, which will further strengthen its liquidity position. More specifically, HF's available liquidity enables the company to support its debt service requirements (currently totalling approximately GBP100 million per annum) even in the absence of dividends upstreamed from HSP, which would normally represent the company's exclusive source of cash flow. HF's next debt maturity is in 2024. The HF group is also implementing initiatives aimed at further reducing, where possible, its cost base and investment spend, with the objective of supporting its liquidity and financial profile in the short term. The HF group expects to have sufficient liquidity to meet all its obligations into 2022 under the extreme stress test scenario of no revenue, or well into 2023 under its own base case traffic forecast, which envisages a traffic contraction of 72% in 2020, with passenger levels in 2021 expected to remain around 54% below 2019.

Given the magnitude of the reduction in earnings associated with traffic declines, HF will trigger default financial covenants included in its debt documentation, namely group Net Debt/RAB of 92.5% (both at the December 2020 and December 2021 calculation date) and Interest Cover Ratio of 1.0x (at the December 2020 calculation date). In addition, the group's debt documentation includes covenants at the level of HSP. Given the contraction in cash flows, HSP's Interest Cover Ratio will trigger lock-up levels at the December 2020 calculation date, which means that the company will not be permitted to upstream cash to HF. In the context of the trigger of default financial covenants, HF obtained a waiver for the Interest Cover Ratio covenant in 2020 and to increase the HF Net Debt/RAB threshold to 95% in 2020 and 93.5% in 2021. In addition, HF will not distribute dividends for the duration of the waiver period or, if later, until Net Debt/RAB reaches the level of 87.5% or below. The group does not expect further covenant breaches in 2021.

## FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

In light of the current negative outlook, upward rating pressure on HF's ratings is unlikely in the near future. More generally, positive rating pressure would only develop if, following the lifting of border and travel restrictions, the control of the coronavirus pandemic and a return to more normal traffic performance, the company's financial profile and key credit metrics sustainably strengthen, leading to restoring an appropriate headroom under its Net Debt/RAB covenant and an AICR consistently higher than 1.0x, while continuing to maintain a good liquidity profile.

Downward pressure on HF's ratings could develop if (1) it were to exhibit a financial profile leading to an AICR level continuously below 1.0x; (2) the group reports a permanently impaired flexibility versus its event of default financial covenants or a risk of extended covenant breaches; (3) the liquidity profile deteriorates significantly; or (4) it appeared likely that the coronavirus outbreak had a more severe or sustained detrimental impact on traffic levels.

The principal methodology used in these ratings was Privately Managed Airports and Related Issuers published in September 2017 and available at [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_1092224](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1092224). Alternatively, please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

The only asset of HF is its shares in HSP, a holding company which in turns owns the company that owns LHR, Europe's busiest airport in terms of total passengers. HF is indirectly owned by Heathrow Airport Holdings Limited (HAH). HAH is ultimately owned 25% by Ferrovial S.A. (a Spanish infrastructure & construction company), 20% by Qatar Holding LLC (a sovereign wealth fund), 12.62% by Caisse de depot et placement du Quebec (a pension fund), 11.2% by the Government of Singapore Investment Corporation (a sovereign wealth fund), 11.18% by Alinda Capital Partners (an infrastructure fund), 10% by China Investment Corporation (a sovereign wealth fund) and 10% by the University Superannuation Scheme (a pension scheme).

## REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: <https://www.moodys.com/researchdocumentcontentpage.aspx?>

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At least one ESG consideration was material to the credit rating action(s) announced and described above.

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