FITCH ASSIGNS MANCHESTER AIRPORT GROUP FUNDING PLC 'BBB+(EXP)' EXPECTED RATINGS; OUTLOOK STABLE

Fitch Ratings-London-31 January 2014: Fitch Ratings has assigned Manchester Airport Group Funding PLC's (MAG Funding, or the issuer) senior secured notes expected ratings, as follows:

GBP5bn Multicurrency Note Issuance Programme: ‘BBB+(EXP)’; Outlook Stable
GBPTBD fixed rate bonds: 'BBB+(EXP)'; Outlook Stable

The final rating is contingent upon the receipt of final documents conforming to information already received.

The ‘BBB+(EXP)’ rating reflects a combination of solid business attributes and debt structure. This is weighed down by factors including weak historical volume resilience, although Fitch believes that the company may be through the trough, which offers reasonable ‘catch up’ potential. There are certain corporate-style features that reduce the impact of the debt structure.

Manchester Airport Group PLC (MAG) is the UK’s second-largest airport group, operating four international airports in England with aggregate passenger throughput of 42 million in 2013. The portfolio primarily comprises Manchester Airport (MAN) and Stansted Airport (STN), the third and fourth largest airports in the UK, with 19.8 million and 17.5 million passengers in FYE March 2013, respectively. It also includes smaller operations at East Midlands Airport (EMA; 4.0 million passengers) and Bournemouth Airport (BMTH; 0.7 million passengers). Fitch concentrated its credit analysis on MAN and STN because of their operational and financial predominance (together they represented about 89% of passengers and just under 90% of revenue in FYE March 2013).

KEY RATING DRIVERS
Fitch's ratings are based on the following factors, among others:

Volume Risk – Midrange
Both MAN and STN are among the group of European airports that were worst affected by the 2007-2010 financial crisis, with each registering declines in traffic of 19% and 22% respectively, although Fitch believes both airports are now over the worst period of volatility. However, there is the possibility that an element of historical lost growth may prove difficult to fully regain.

MAN can be characterised as a prime airport in a weaker catchment area than many Fitch-rated European airports (i.e. for 3Q08-3Q13, regional UK pax volumes (rolling four quarters) fell by 15%), whereas STN can be characterised as a tertiary airport in a strong catchment area (3Q08-3Q13 pax volumes were flat). Their respective roles in the aviation system are more secondary in nature. In aggregate, they mainly serve outbound leisure passengers, typically vulnerable to swings in the discretionary spending and propensity to fly of the typical ABC1 demographic, although STN has a strong inbound dynamic (43% of STN pax). This explains much of the past underperformance. From a backward-looking perspective, both MAN and STN would probably rank “Weaker” for Volume Risk. However, considering the low starting point (post-financial crisis) and limited growth embedded in the business plan, the forward-looking perspective offers potentially improved resilience. Fitch believes that MAN’s performance during the financial crisis could have been exacerbated as a result of a failure to embrace low cost carrier (LCC) airlines, causing it to lose substantial regional market share. Continuing to exploit the rising LCC trend is now embedded in the management strategy at MAN.

Similarly, STN's relatively weak performance since 2007 has been due to both a substantial increase in aeronautical tariffs (STN's annual pax volumes declined by 26.6% for 2007-12, compared with 3.4% for the general London market). Nevertheless, MAG's business plans, which see STN enter into a number of commercial arrangements that incentivise growth and deliver increased contribution over the medium term, are relatively conservative and detailed, and do not anticipate STN regaining its 2007 pax volume until after 2018. In particular, Fitch derives comfort from long-term contracts with Ryanair and easyJet that de-risk growth and support future revenues at STN.

Price Risk – Midrange

MAN's deregulation in 2009 means it is no longer subject to economic regulation by the Civil Aviation Authority (CAA) and, as such, along with EMA and BMTH it has complete price-setting flexibility (although its ability to recover lost revenue as a result of traffic falls by increasing tariffs may be limited by its lack of substantial market power).

STN will be deregulated from 1 April 2014, as the CAA has determined that STN does not have substantial market power. Separately, the relatively small cargo market (9% of STN's aeronautical revenues) may be subject to economic regulation, but the case has yet to be concluded. Full pricing flexibility continues to support MAG's medium-term aim to reduce overall aeronautical tariffs at STN. Uncertainty regarding how full commercial pricing will work in practise is offset by MAG's steady stewardship of MAN's unregulated framework (for effectively one whole five-year regulatory cycle) and long-term contracts with STN's main airline customers, Ryanair and easyJet.

Infrastructure Development and Renewal - Stronger

All of MAG's airports have seen substantial capital investment over recent years. Infrastructure is generally relatively new (more so for STN) and all airports have excess capacity at present. As such, group capex requirements over the coming years appear limited. We consider that the capex plans in place are well-detailed, and that MAG has the experience and capability to ensure assets are appropriately maintained.

Debt Structure - Midrange

MAG Funding is a fairly typical secured corporate transaction with the exception of some corporate-style weaknesses related to all bullet debt maturities, a lack of debt maturity concentration limits, no provision for downgrade or collateralisation protection from financial counterparties and no independent director at issuer level. The issuer benefits from senior security (including a 'qualifying' floating charge), a defined hedging policy and dedicated liquidity equivalent to 12 months' debt service.

Fitch's quantitative analysis concludes that MAG has a fairly conservative leverage profile compared with other similarly rated airports. Given the bullet maturity of MAG's debt and the fact that MAG holds majority freehold (STN and EMA) or long leasehold (MAN and BMTH) assets, Fitch has generated a synthetic 25-yearr annuity DSCR of 1.99x (five-year average) and 1.68x (minimum). Fitch's lease-adjusted net debt/EBITDAR is 3.77x (five-year average) and 4.36x (maximum).

Viewed purely on metrics, the transaction could achieve a 'A-' rating. However, MAG's operating profile is weaker than that of most rated European airport operating peers. This is partly mitigated by a relatively conservative business plan and strong recent track record in delivering positive change to MAN. STN's operating profile, in particular, has been strengthened by medium-term volume contracts with Ryanair and easyJet, a positive and unique contractual framework within the large scale European airport sector, although this does expose MAG to enhanced counterparty risk. Currently the two main airlines involved have a healthy financial position (i.e. large cash balances, negligible net leverage), despite operating in the traditionally volatile aviation market.

RATING SENSITIVITIES

Weak financial performance as a result of lower passenger volumes, increased costs or adverse regulatory rulings affecting MAN or STN could result in a negative rating action (as characterised by sustained Fitch leverage above 4.5x).

Negative rating action could also be prompted by a significant increase in counterparty risk relating to material contracts (ie disputes or significant deterioration in creditworthiness relating to the airline revenue agreements or other guaranteed contracts). A failure to implement the company's assumed medium-term funding structure could also result in negative rating action.

The ability to deliver the business plan consistently over a number of years and achieve a more resilient operating profile, particularly at STN, could result in positive rating action (as characterised by sustained Fitch leverage below 3.0x).

SUMMARY OF CREDIT

The issuer is a special purpose vehicle set up specifically in order to issue bonds on behalf of MAG, the owner of all four airports. All funds raised by the issuer are on-lent to a MAG subsidiary in the form of issuer-borrower loans, with the issuer benefiting from a comprehensive covenant package and pari passu share in security along with other senior creditors.

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Additional information is available on www.fitchratings.com

Applicable criteria, 'Rating Criteria for Infrastructure and Project Finance' dated 11 July 2012, and 'Rating Criteria for Airports', dated 13 December 2013 are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Rating Criteria for Infrastructure and Project Finance
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=682867
Rating Criteria for Airports
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=725296