FitchRatings

FITCH UPGRADES ST. LOUIS LAMBERT INT'L AIRPORT (MO) TO 'A-'; OUTLOOK REVISED TO STABLE

Fitch Ratings-Chicago-06 October 2017: Fitch Ratings has upgraded St. Louis Lambert International Airport, MO's approximately $324.5 million outstanding airport revenue bonds to 'A-' from 'BBB+'. St. Louis also has $305.8 million of series 2012, 2013, 2015, and 2017 parity airport revenue bonds that are not rated by Fitch. The Rating Outlook is revised to Stable from Positive.

The upgrade reflects continued favorable trends in enplanement growth combined with stable debt service coverage ratios (DSCR), and an improving leverage position that falls to 5.16x by 2022 in Fitch's rating case.

KEY RATING DRIVERS

Summary: The rating reflects St. Louis Lambert's status as a medium hub airport with stable financial metrics, limited competition from other airports and modes of transportation, manageable capital needs in the medium term, and expected maintenance of coverage levels consistent with recent norms. The rating also reflects modest carrier concentration, with Southwest Airlines representing 53% of total enplanements.

Solid Underlying Demand (Revenue Risk - Volume: Stronger - Revised from Midrange): The airport is the primary air service provider for the St. Louis metropolitan statistical area with limited competition from nearby alternatives. The airport's traffic profile has shifted over the past decade and it currently serves as an origination and destination (O&D) airport, with O&D representing 82% of the approximately 7.2 million total enplanements. While modest carrier concentration exists with Southwest Airlines (53% of total enplanements in fiscal 2016), it is partially mitigated by the airline's long-term commitment to the airport and its increased service levels.

Favorable Airline Use & Lease Agreement (Revenue Risk - Price: Midrange): The airline use agreement (AUL) provides a hybrid compensatory rate-setting approach that ensures operating and debt service costs can be recovered through a residual-oriented financial backstop. The AUL commenced in 2016 and expires in 2021. Airline costs are slightly elevated at $12.07 per enplanement for estimated fiscal 2017 (ending June 30) but are expected to decrease nominally in conjunction with a declining debt service profile and increasing enplanement base.

Modest Capital Needs; Future Borrowing Expected (Infrastructure Development & Renewal: Stronger): The AUL includes a pre-approved five-year capital investment program (CIP) totalling $170 million from fiscal 2017 to fiscal 2021. Approximately $86 million is debt funded, $58 million of which was issued in fiscal 2018. The airport plans to issue the balance of $28 million in fiscal 2020. The remaining capital needs are funded by the airport's development fund and other equity sources. The CIP has received majority-in-interest (MII) approval from signatory carriers, and focuses on the maintenance, refurbishment, and modernization of airport assets.

Conservative Debt Structure (Debt Structure: Stronger): All of the airport's debt is fixed-rate with a declining amortization profile. Maximum annual debt service (MADS) of $69 million is scheduled in fiscal 2018. Debt service declines in subsequent years through maturity in 2047. Bond covenants and reserve requirements are satisfactory for an airport at this rating level.

Financial Metrics: Net debt-to-cash flow available for debt service is modest and remains comparable to peers at 5.82x for estimated fiscal 2017. Indenture-based debt service coverage (including PFCs and coverage as revenues) is adequate and remained relatively flat at 1.35x in estimated fiscal 2017. The airport has a sufficient balance sheet position equating to around 354 days cash on hand.

Peer Analysis: St. Louis' peers include Cleveland (BBB+/Stable) and Pittsburgh (A/Stable). Both airports have previously served as domestic hubs and have transitioned to primarily O&D airports. St. Louis' leverage (5.82x for estimated fiscal 2017) and cost per enplanement (CPE; $12.07 for estimated fiscal 2017) compare favorably to Cleveland's fiscal 2016 metrics of 6.98x and $20.31. Conversely, Pittsburgh has lower leverage (1.86x for fiscal 2015) though the gap may contract with Pittsburgh's new capital program and CPE should remain comparable to St. Louis.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action:

--Leverage rising above 8x on a sustained basis;
--Operational volatility associated with material enplanement declines or uncontrolled airline costs.

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action:

--Continued favorable trends in enplanement growth leading to increased CFADS and causing leverage to devolve below 5x on an ongoing basis.

CREDIT UPDATE

Performance Update

Enplanements increased a robust 7.7% to 7.2 million in fiscal 2017, building upon the strong 6.5% growth experienced in fiscal 2016. These recent trends well exceed the five-year CAGR of 2.5% (fiscal 2012 to fiscal 2017). The addition of new destinations has been a partial catalyst for this growth. In fiscal 2016, the airport added eight new destinations and in June 2017 Southwest added service to Charleston, SC and Pensacola, FL. Robust traffic growth continues into fiscal 2018 with enplanements up 7.2% in July 2017 over the previous year.

Revenue decreased by 1.5% to $141 million in fiscal 2016, but was largely due to a reduction in air carrier fees from lower landing fee rates. Preliminary results for fiscal 2017 indicate revenue growth of 15.2%, partially due to increased charter activity. Expenses decreased by 1% to $79.9 million in fiscal 2016 primarily due to a mild winter and associated decreases in utility and fuel consumption, de-icing chemicals, and other snow related expenses. Preliminary results for expenses show an increase of 9.4% to $87.4 million for fiscal 2017. The increase is due to greater snow-related expenses after a mild winter and higher contractual services, such as building repairs and maintenance and other miscellaneous contractual services.

The result was estimated indenture DSCR of 1.35x in fiscal 2017, in line with recent historical performance. CPE rose to $12.07 in estimated fiscal 2017 from $11.99 in fiscal 2016, but should begin to temper with falling debt service obligations and future enplanement growth. Positively, leverage continues to moderate, falling to 5.82x in estimated fiscal 2017 from 6.32x in fiscal 2016.

The city is considering privatization of the airport and issued an RFP for an independent advisory team. The RFP is due in October 2017. The FAA accepted St. Louis' preliminary application in April 2017 for the Airport Privatization Program (APP). Next steps include choosing a private operator that meets APP criteria and negotiating an operations agreement, which would require approval by the airlines, city, Airport Commission, and FAA. Privatization is only in the exploration phase and there is not a strict deadline to pursue the privatization. The airport continues to operate under its current structure, and Fitch will continue to monitor the situation for any potential credit implications.

Fitch Cases

Fitch's cases, which forecast through fiscal 2022, incorporate elements of the issuer's consultant-based traffic and revenue assumptions but also include additional Fitch assumptions and stresses. The Fitch cases incorporate the expected debt issuance of $28 million in fiscal 2020. Preliminary results are used for fiscal 2017 and the budget is used for fiscal 2018.

Under the base case, Fitch adopts the consultant forecast for enplanements, which grow at a CAGR of 2.2% from estimated fiscal 2017 to fiscal 2022. Non-airline revenues are driven by annual traffic changes and airline revenues are adjusted to maintain debt service coverage consistent with historical norms. Average indenture-based DSCR is 1.34x from estimated fiscal 2017 to fiscal 2022. Excluding coverage, it is tighter, averaging 1.14x. The average CPE over this period is $10.07. Leverage averages 5.4x, falling to 4.5x by 2022.

Under the rating case, traffic increases by 4.6% in fiscal 2018 followed by a decline of 8% in fiscal 2019. Traffic recovers 2.5% per annum in subsequent years. Airline revenues are greater than in the base case and incorporate a 3% increase in fiscal 2019 to offset the 8% traffic stress (compared to an 11% reduction in the base case for 2019). Operating expense growth is reduced in the year traffic declines and subsequently increases at a 50 bps stress to the base case, resulting in a 3.8% CAGR (compared to 2.2% in the base case). Average indenture-based DSCR is 1.33x from estimated fiscal 2017 to fiscal 2022 (1.13x excluding coverage). Average CPE is $11.62 and leverage averages a slightly higher 5.6x, falling to 5.2x by 2022 and still commensurate with the current rating level.

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Applicable Criteria

Rating Criteria for Airports (pub. 14 Dec 2016)
https://www.fitchratings.com/site/re/891804
Rating Criteria for Infrastructure and Project Finance (pub. 24 Aug 2017)
https://www.fitchratings.com/site/re/902689