

Credit Opinion: N.V. Luchthaven Schiphol

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Amsterdam, Netherlands

Ratings

CategoryMoody's RatingOutlookStableSenior Unsecured MTN -Dom CurrAa3Schiphol Nederland B.V.StableOutlookStableSenior Unsecured -Dom CurrAa3

Contacts

Analyst Phone
Andrew Blease/London 44.20.7772.5454
Johan Verhaeghe/London
Stuart Lawton/London

Key Indicators

N.V. Luchthaven Schiphol

	Dec-2005	Dec-2004
Adj. EBITA margin	33.3%	31.3%
Adj. EBITA / Average Assets	8.6%	n/a
Adj. EBITA Interest Coverage	6.0	5.1
Adj. FFO Interest Coverage	7.0	6.4
Adj. FFO / Net Debt	36.1%	32.2%
Adj. RCF / Net Debt	30.8%	27.6%

Note: For definitions of Moody's most common ratio terms please see the accompanying <u>User's Guide</u>.

Opinion

Rating Rationale

N.V. Luchthaven Schiphol ("Schiphol Group") is a holding company of a group that owns and operates Amsterdam Airport, Rotterdam Airport, Lelystad Airport, and 51% of Eindhoven Airport, which together comprises most of the airport capacity in the Netherlands. In addition Schiphol Group has minority investments in a number of overseas airports. The largest of the Dutch airports, Amsterdam Airport Schiphol ("Schiphol"), is the fourth largest airport in Europe by passenger numbers. Schiphol Group is currently owned 76% by the Kingdom of Netherlands, 22% by the Municipality of Amsterdam and 2% by the Municipality of Rotterdam.

The Dutch Government has earmarked Schiphol for privatisation for a number of years. In 2006 it implemented all the necessary legislation to make this effective and was progressing to sell down to a level that was to retain the joint Government and municipality interest at 50.1%. While the Municipality of Amsterdam had taken steps to block the sale, the Government had progressed all legal means to ensure that the sale could proceed. However in November 2006, following Dutch elections, the political complexion of the Dutch Parliament changed, and following inter-party discussions, the Dutch Government announced that the privatization by means of an Initial Public Offering will not be considered during the next parliamentary term. However, partial privatisation remains a distinct possibility over the medium term.

Schiphol Group's Aa3 rating reflects the combination of the following inputs, (a) a Baseline Credit Assessment of 5, (b) the Aaa local currency rating of the Government of the Kingdom of the Netherlands, (c) low Dependence, and (d) medium Support.

The Baseline Credit Assessment of 5 reflects (1) Schiphol Group's ownership of the fourth largest airport in Europe and the other Netherlands airports, (2) its good debt coverage and reasonable financial flexibility, (3) its relatively high exposure to transfer traffic and reliance on Air France KLM, and (4) its moderate capital expenditure programme, which is somewhat counteracted by certain operational constraints which may constrain the pace of volume growth. Schiphol Group's Baseline Credit Assessment is considered well positioned in the 5 category.

The low Dependence recognises that factors other than domestic economic performance have a material impact on Schiphol, e.g. propensity for international travellers to visit the Netherlands, the propensity for passengers to spend at the airports, and the success of airlines attracting transfer traffic to Amsterdam Airport.

The medium Support reflects the ownership by the Dutch Government and Amsterdam and Rotterdam Municipalities, which may be reduced as part of a privatisation process, but will very likely remain at a minimum of 50.1% over the medium term, together with Schiphol's role as a critical component of the Netherlands' international transport network.

The Dutch Government was focused on ensuring that Schiphol's position as a major aviation hub was preserved during the negotiations between Air France and KLM which evidences the importance it attaches to Schiphol.

Moody's last rating action was on 23 June 2005 when it affirmed the Aa3 rating following the implementation of its rating methodology for government-related issuers.

Moody's would see major European airports in the A rating category (5 to 7 range for Baseline Credit Assessment) as having credit metrics broadly within the range (i) Adjusted Funds From Operations ("Adj FFO") to Interest of between 3.5 and 7.0 times, and (ii) Adjusted Retained Cash Flow ("Adj RCF") to Net Adjusted Debt of between 10% and 25%. Hence, Schiphol's current capital structure and cash flow generation position it towards the top end of this range. However, note that the qualitative judgments with regard to business risk for a given airport company are also important inputs into a rating.

Following constrained traffic conditions caused by the Sep 11 attacks, the Iraq War and SARS, the European airport sector has generally seen growth rates reverting back to long term trend (+4-5% per annum) over the recent past. We would expect Schiphol to see growth rates broadly in line with this trend. The long term industry growth has focused airport managements' attention on upgrading infrastructure and expanding capacity.

Schiphol is fortunate in that, given its existing configuration and number of runways, it does not require very substantial levels of capital expenditure to accommodate expected growth. Most airport companies serving major cities in Europe are state owned but where they are not their monopoly characteristics usually require that they be subject to a framework of economic regulation. Schiphol's aviation activities are now governed by a framework of economic regulation, introduced as a prelude to privatization.

Schiphol has a virtual monopoly of air traffic to and from the Netherlands, a position supported by Schiphol's excellent inter-modal transport connections. However, the company also has a relatively high exposure to transfer traffic, in fact the highest of any airport group rated by Moody's, hence leaving it relatively exposed to the fortunes of its main hub carrier. The Air France KLM Alliance accounts for approximately 60% of total passengers and so the fortunes of this airline will have a material impact on Schiphol's future traffic volumes. Although there are inevitable uncertainties over the shape of the Air France KLM route network over the medium term, to date the impact on Schiphols' traffic volumes has been positive.

Following the completion of the fifth runway in 2003, Schiphol has no sizeable large capital expenditure project on the horizon and only needs to undertake modularised expenditure to deal with growth as it arises. This gives the company significant flexibility in downside traffic scenarios. While physical capacity is substantial, there are environmental constraints that place a limit on the number of aircraft movements, therefore without relaxation of these requirements, traffic growth will be constrained over the longer term.

Following the implementation of a legislative decree in July 2006, Schiphol is subject to a dual till system of economic regulation, and therefore operates with a regulated return on a defined aviation asset base, based on an assumed average cost of capital and a proposed capital expenditure plan based on the forward requirements of users of the airport. The charges are set by Schiphol in accordance with the regulatory framework and possible disputes with its airline customers are referred to the relevant Dutch Government agency (Competition Authorities). This is a new regulatory framework, and while it appears rationale, its long term suitability remains untested.

Schiphol Group has traditionally had a conservative financial structure with a modest amount of debt leverage, and currently pays a moderate dividend to its shareholders. This affords a good degree of financial flexibility and is a material factor in Schiphol Group's 5 baseline credit assessment. This policy is unlikely to change materially while Schiphol remains owned by the Dutch Government and the municipalities, but the possibility that the Dutch Government may alter Schiphol Group's capital structure prior to any future partial privatization cannot be ruled out.

The stable outlook recognises that Schiphol Group is well positioned within the 5 Baseline Credit Assessment category with a reasonable level of financial headroom for the category. This position is expected to be underpinned by the prospects of reasonable revenue growth over the medium term, a moderate capital expenditure programme which is not expected to result in substantial increases in debt, and an expectation that Schiphol Group will maintain a cautious approach to non core investment.

Furthermore, the medium Support factor is not expected to change, given that it accommodates a reduction in Government ownership down to 50.1%, and recognises that over the medium term there is a strong likelihood that a Government will reduce its percentage ownership in Schiphol, while still retaining majority control.

What Could Change the Rating - UP

Given that Schiphol Group is positioned towards the top end of the rating range for major airport companies, a material de-leveraging of Schiphol would be required to see an upwards move in the rating. This is not considered likely in the short to medium term given Schiphol's likely financial commitments.

What Could Change the Rating - DOWN

A reduction in FFO Interest Cover materially below 5.5 times or Adjusted RCF to Net Adjusted Debt substantially below 20%, could result in a downwards move in the rating. This could come from a return of capital to shareholders either before or after any future privatisation.

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