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Research Update:

Royal Schiphol Group N.V. Upgraded To 'A/A-1' On Stronger Than Anticipated Deleveraging; Outlook Stable

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Rating Action Overview

- We expect Royal Schiphol Group N.V. (Schiphol) to deleverage faster than anticipated over 2023-2025, on the back of stronger traffic (84% of 2019 levels year-to-date in July) and debt reduction efforts, including the voluntary €380 million notional debt repayment in May 2023 facilitated by the €600 million of net proceeds received as part of the unwinding of the cross-shareholding agreement with Aeroports de Paris.
- Materially higher expected tariffs from April 1, 2025, owing to Schiphol's supportive regulatory framework, could result in a temporary spike in funds from operations (FFO) to debt that year from about 11% on average over 2023-2024, but it will likely decline from 2026 while remaining well above 9%.
- We do not consider the higher expected charges and expected 440,000 cap on air transport movements (ATMs) from 2024 to weaken Schiphol's competitive strength relative to rated peers but assume lower traffic growth than other European hubs in our base case and require healthy metrics for any further positive rating action.
- We therefore raised our long- and short-term issuer credit ratings on Schiphol to 'A/A-1' from 'A-/A-2' and our issue ratings on Schiphol's senior unsecured debt to 'A' from 'A-'. Our ratings reflect two notches of uplift to our 'bbb+' assessment of Schiphol's stand-alone credit profile (SACP) due to our view of a moderately high likelihood of extraordinary government support.
- The stable outlook reflects our view that Schiphol will continue to deleverage, supported by a further recovery in air traffic, its supportive regulatory framework, and prudent financial policy.

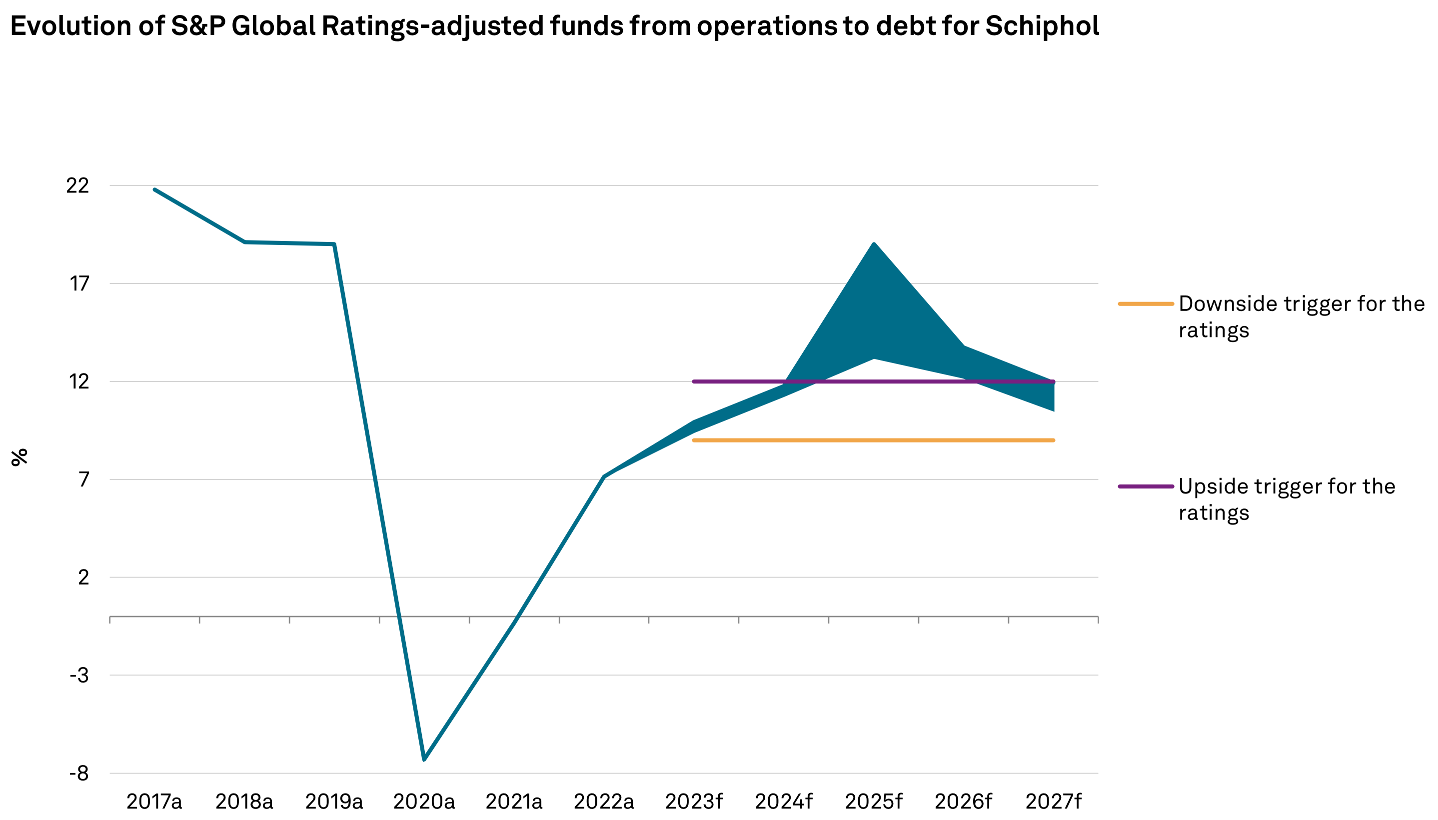
Rating Action Rationale

The upgrade reflects our view that Schiphol will deleverage faster than we anticipated, with FFO to debt increasing on average to about 11% over 2023-2024. We have revised our traffic assumptions for Schiphol upward to 86% of 2019 levels in 2023 and 90% of 2019 levels in 2024 from about 80% in 2023 and about 85%-88% in 2024 in our previous forecasts. This is despite high inflation and interest rates, as well as more expensive ticket prices, which may negatively affect consumers' discretionary spending on travel. Our new assumptions are based on volumes already increasing to about 84% of 2019 levels for the first seven months of 2023, further capacity being deployed by airlines, as well as Schiphol's recent measures to mitigate staff shortages at security and baggage handling, resulting in about €120 million of additional costs in 2022. Although there were still minor capacity constraints in 2023, with a 5% reduction in passengers in the morning peak hours during the May holidays, we assume a further recovery in 2024 supported by Schiphol recruiting new staff, including 1,050 additional security employees. In first-half 2023, the company reported underlying EBITDA of about €218 million and we expect a stronger second half, reflecting the crucial summer period, leading to S&P Global Ratings-adjusted EBITDA of about €500 million-€520 million in 2023. This should result in S&P Global Ratings-adjusted FFO to debt of about 10% in 2023 followed by about 12% in 2024, which is stronger than our previous expectations.

We assume the company's focus on deleveraging will mitigate the effects of high inflation and large planned capital investments. In May 2023, Schiphol voluntarily repaid €380 million of notional debt, including the €300 million notes maturing in 2025. This was facilitated by the €600 million net cash inflow received at year-end 2022 from the unwinding of the cross-shareholding agreement between Aeroports de Paris and Schiphol, which was not factored in our previous base case. In addition, we assume the group will likely postpone dividends until 2026 at the earliest, considering high inflation and capital expenditure (capex) over the next two years, and in line with its long-term financial targets of restoring reported net leverage to below 5.0x from 8.9x on a 12-month rolling basis as of June 30, 2023, and FFO to net debt to above 14% from 8.3% on the same basis. The latter could occur by 2025 under our base case. This will leave room for the large planned investments of above €1 billion per year starting 2024, including mainly quality, safety, and sustainability capex rather than capacity expansion. The plan to build an additional runway at Schiphol airport was cancelled earlier this year while the decision to build a new terminal is still pending. Our capex forecasts comprise about €200 million-€300 million per year on average for maintenance.

Significantly higher expected tariffs for Schiphol's next regulatory period (2025-2027) could result in a temporary spike in FFO to debt in 2025, before declining from 2026. We expect tariffs will increase significantly in 2025, with April 1, 2025, the start of the new three-year regulatory period. This is in line with Schiphol's supportive regulation and its good track record of implementing tariffs in line with the regulatory framework. The strong expected increase, after 12% hikes in both 2023 and 2024, reflects that Schiphol is entitled to reset its cost base to reflect the higher actual inflation compared to that incorporated over the 2022-2024 regulatory period, with a 13%-14% gap estimated in total for the three years. Besides, tariffs are expected to increase due to lower traffic when the cap on ATMs is implemented, compensation for volume risk during COVID-19 years, and higher-than-expected operating expenses to meet expanding passenger demand at terminals over 2022-2024. We will closely monitor future tariff developments since a formal consultation process between the airport and the airlines still needs to start. We will have more visibility by October 2024, when the charges are expected to be finalized, with the final approval from the regulator ultimately on March 31, 2025. The expected increase in aeronautical charges could result in a temporary spike in FFO to debt in 2025, depending on the tariff level approved. However, as dividends are expected to restart, capex remains high, and debt maturities are refinanced at higher interest rates, we expect FFO to debt will decline from 2026, while remaining well above 9%.

Chart 1



f--S&P Global Ratings' forecast. Source: S&P Global Ratings.

At this stage, we do not consider the higher expected charges will weaken Schiphol's competitive position relative to its rated peers, but assume lower traffic growth than other European hubs. In our base case, we assume traffic is unlikely to reach 2019 levels, even by 2027. Schiphol has high exposure to transfer traffic, at 36.2% of total passenger volumes in the year to date as of July 2023, which exposes the group to greater competition from other European hubs like Heathrow in London and Charles de Gaulle in Paris. Starting 2025, we therefore forecast annual passenger growth of 1.6%-1.7%, broadly in line with European GDP, and much lower than seen before 2019. This reflects the potential impact of higher charges on passenger numbers, in addition to the expected 440,000 cap on ATMs from 2024. It also incorporates that some transfer traffic could be lost to competing airports, depending on European peers' future price increases amid high inflation, as well as final charges approved for the new regulatory period. In 2022, Schiphol's charges were still significantly lower than Heathrow's but not far behind Aeroports de Paris' Charles de Gaulle. At this stage, we do not consider this uncertainty to weaken Schiphol's competitive strength relative to its rated peers such as Heathrow Funding Ltd. (Class A issue rating BBB+/Stable/--; Class B issue rating BBB-/Stable/--) and Aeroports de Paris

(A/Negative/--), which have the same business risk assessment. This is because Schiphol compares positively in terms of regulation, being one of the few European airports to benefit from a traffic-risk-sharing mechanism.

Schiphol's capacity constraints weigh on its long-term earnings profile. In our base case, we assume the capacity cap to 440,000 ATMs from 500,000 ATMs per year, or a 11% reduction from 2019, will be implemented in late 2024 compared to 2023 previously. The negative effects of the cap on passenger traffic growth could be mitigated by airlines currently renewing their fleet with larger aircraft, which is expected to increase capacity 5%-10% on certain routes in the coming years, according to the company; higher load factors; shifts from cargo slots to passenger aircraft; and compensation for lower-than-expected volume over the current regulatory period (2022-2024) when the capacity cap is introduced. We understand that the capacity cap would be in place for up to five years, while the government develops alternative environmental limits that may replace it. Although it is currently unclear how the government will implement these limits, we see heightened risk of environmental policy objectives potentially hampering Schiphol's operations in the longer term.

We also understand there could be delays to the cap's implementation, especially since the Dutch government, who initiated the process on June 24, 2022, resigned on July 7, 2023. The first step relates to the introduction of a temporary rule reducing the maximum number of ATM from 500,000 to 460,000. This was planned to be implemented from Nov. 1, 2023, but we understand it could be delayed to 2024. Following a lawsuit initiated by several airlines (including national carrier KLM), a court ruled in April 2023 that Schiphol could not implement the 460,000 cap. However, the state appealed the court decision, which was finally annulled in July 2023. The second step relates to the reduction of ATMs to 440,000, for which the state must comply with the EU requirement for a 'balanced approach', including evaluating other valuable alternatives. The opening of the airport at Lelystad, which could absorb some traffic from Schiphol including smaller planes, has been pending since 2019.

We continue to believe that Schiphol benefits from a moderately high likelihood of extraordinary government support if needed. As such, we apply two notches of uplift to our 'bbb+' assessment of Schiphol's SACP. We continue to believe that Schiphol has an important role for the Dutch government, given the group's main asset, Amsterdam Airport Schiphol, is essential infrastructure and a key element of the Netherlands' open and export-oriented economy. In our view, there is a clear need for the airport to operate without disruption, because any interruptions could have a significant impact on the economy. We also believe that Schiphol has maintained a strong link with the Dutch government, and the government has a track record of supporting entities such as Schiphol.

Outlook

The stable outlook on Schiphol reflects our view that its FFO to debt will improve to about 11% on average over 2023-2024, from 7.2% in 2022, supported by the recovery in air traffic, good control over costs, and Schiphol's supportive regulatory framework and prudent financial policy. It also reflects our view that FFO to debt will decline from the potential temporary spike expected in 2025, as dividends are expected to restart, capex remains high, and the average cost of debt increases, while remaining well above 9%.

Upside scenario

We could take a positive rating action over the next 12 months pending further visibility on final charges approved for the next regulatory period (2025-2027), and as we get more clarity on how the expected increase in charges is spread over 2025-2027.

We could raise our rating if the company's performance and financial policy actions demonstrate it can maintain FFO to debt above 12% and we believe these metrics will be sustained beyond 2025, as dividends are expected to restart, capex remains high, and the average cost of debt increases. Such a healthy threshold incorporates the potential risk in relation to the 440,000-ATM capacity cap as well as the effect that materially higher expected charges from 2025 could have on Schiphol's future growth prospects and its competitive position as a hub airport.

Downside scenario

We could lower the rating by one notch if:

- The group cannot maintain FFO to debt above 9%. This could happen if, for instance, the company's financial policy becomes more aggressive than currently anticipated or its performance is weaker than expected.
- The quality of the company's earnings profile weakens further due a material deterioration in its competitive position. This could be amid further environmental or other regulations that adversely affect the company's stability and predictability of cash flows.

All else being equal, a one-notch downgrade of the Netherlands will not affect the rating on Schiphol.

Company Description

Schiphol owns and operates the largest of the Dutch airports, Amsterdam Airport Schiphol, which is one of Air France-KLM's two major hubs. Before the pandemic, the airport catered for almost 72 million passengers and was the third largest in Europe by number of passengers and cargo volumes. Schiphol has a virtual monopoly on air travel originating and ending in the Netherlands and remains a major driver of the Dutch economy.

In addition to its operations in Amsterdam, a major capital city in Europe, Schiphol also owns and operates Lelystad Airport and Rotterdam Airport and holds a 51% stake in Eindhoven Airport. Its international operations include a 19.61% stake in Brisbane Airport, a 35% stake in Hobart International Airport (Tasmania), and a management contract for Terminal 4 of John F. Kennedy Airport in New York.

Schiphol operates in four main business lines:

- Aviation (58% of 2022 revenue);
- Consumer products and services--including retail and parking (17%);
- Real estate (14%); and
- Alliances and partnerships (11%).

In 2022, the group generated €1.49 billion of revenue and reported underlying EBITDA of €361 million.

Schiphol is 69.8% owned by the state of the Netherlands--which supports the rating--20% by the Municipality of Amsterdam, and 2% by the Municipality of Rotterdam, with the remaining 8% being treasury shares.

Our Base-Case Scenario

Assumptions

- Dutch consumer price index growth of 4.8% in 2023, 3.3% in 2024, and 2.3% in 2025.
- Passenger traffic as a proportion of 2019 levels to increase to about 86% in 2023, from 73.2% in 2022, followed by about 90% in 2024, when we expect the capacity cap to 440,000 ATMs from 500,000 ATMs per year will be implemented.
- Starting 2025, annual passenger growth of 1.6%-1.7%, broadly in line with European GDP and much lower than seen before 2019. This is because airport charges are expected to significantly rise starting 2025, which could affect the number of passengers. In addition, it will depend on how fast Schiphol can mitigate the impact of the cap through larger aircraft, higher load factors, and the shift from cargo to passenger slots.
- An increase in airport charges of about 12% in both 2023 and 2024, reflecting the approved tariffs for the 2022-2024 regulatory period. We assume a further significant increase in airport charges in the next regulatory period, reflecting the company's supportive regulation.
- EBITDA margins improve to 28%-29% in 2023, from 25% in 2022, and about 31%-32 in 2024, as higher inflation than factored in the tariffs approved for 2022-2024 and additional costs to address operational issues partly offset traffic recovery. Margins could improve to above 40% thereafter versus 40.7% pre-pandemic, reflecting significantly higher expected tariffs.
- Annual capex of about €780 million in 2023 and increasing to up to €1.0 billion-€1.1 billion thereafter.
- No dividend distributions to shareholders until 2026, when we expect the dividend payout ratio will revert to 60% of the previous year's net profit.

Key metrics

Royal Schiphol Group N.V.--Forecast summary

Industry sector: Air transport

	--Fiscal year ended Dec. 31--						
(Mil. €)	**2019a**	**2020a**	**2021a**	**2022a**	**2023e**	**2024f**	**2025f**
Revenue	1,615	688	816	1,491	1,820	2,040	2,200-2,500
EBITDA (reported)	689	(206)	85	371	514	643	800-1,050
Plus/(less): Other	(31)	65	7	2	2	2	2
EBITDA	658	(141)	91	373	516	645	800-1,050
Less: Cash interest paid	(81)	(72)	(96)	(80)	(107)	(101)	(100)-(110)
Less: Cash taxes paid	(46)	(54)	(3)	(13)	--	--	(35)-(45)

Royal Schiphol Group N.V.--Forecast summary (cont.)

Industry sector: Air transport

	--Fiscal year ended Dec. 31--						
(Mil. €)	**2019a**	**2020a**	**2021a**	**2022a**	**2023e**	**2024f**	**2025f**
Funds from operations (FFO)	531	(267)	(7)	280	409	544	650-900
Debt (reported)	2,772	4,848	5,390	5,350	4,966	4,840	4,750-5,000
Plus: Lease liabilities debt	13	18	17	15	15	15	15
Plus: Pension and other postretirement debt	50	58	49	38	38	38	38
Less: Accessible cash and liquid Investments	(146)	(1,155)	(1,170)	(1,634)	(921)	(294)	(90)-(100)
Plus/(less): Other	60	24	15	25	25	25	25
Debt	2,748	3,793	4,300	3,795	4,124	4,624	4,700-4,950
Cash and short-term investments (reported)	155	1,223	1,240	1,731	976	311	90-100
Adjusted ratios							
Debt/EBITDA (x)	4.2	(26.9)	47.1	10.2	8.0	7.2	4.5-6.5
FFO/debt (%)	19.3	(7.0)	(0.2)	7.4	9.9	11.8	13.0-19.0

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess Schiphol's liquidity as adequate, based on our expectation that liquidity sources will cover uses more than 1.2x for the 12 months to June 30, 2024. In our view, management exercises prudent risk management, the company has a high standing in the credit markets, and its debt documentation is favorable, with limited covenant protections.

Our estimates of Schiphol's principal liquidity sources and uses for the 12 months ending June 30, 2024, are as follows.

Principal liquidity sources:

- Cash and cash equivalents of about €1.2 billion, including €577 million of unrestricted cash and cash equivalents and €645 million in short-term deposits, which we view as accessible and liquid.
- Undrawn and committed credit facilities that mature beyond 12 months of about €500 million, including a €400 million revolving credit facility maturing October 2027 and a €100 million bank line maturing January 2026.
- Estimated cash FFO of about €470 million-€480 million.

Principal liquidity uses:

- Debt maturities of about €309 million.
- Capex of about €932 million. This includes some growth capex but we note that the company has flexibility to manage its needs depending on when the funding is received for these projects.
- No dividends.

Covenants

Schiphol's loan agreements with the European Investment Bank include an own-funds-to-total-assets covenant calculated as equity as a percentage of the total balance sheet. This ratio is tested annually and must remain higher than 30%. As of June 30, 2023, the company was compliant with this covenant, with an own-funds-to-total-assets ratio of 37.3%.

Environmental, Social, And Governance

Environmental factors remain a moderately negative consideration in our analysis of Schiphol. The airport's exposure to noise pollution, the government's decarbonization targets, and the subsequent regulatory constraints that have further limited airport capacity, are likely to affect the company's competitive position and growth prospects, in our view. We see increasing pressure in Europe, and in the Netherlands in particular, to curb carbon emissions and align with the country's net-zero carbon targets. Amid a weaker operating environment with rising inflation, we believe this will strain and slow the company's deleveraging efforts following the height of the pandemic. We no longer expect the airport to recover to 2019 passenger levels over our projection horizon, which will weigh on the company's cashflow. In April 2023, the airport announced additional measures toward noise and carbon dioxide emissions reduction including a potential ban on night flights (less than 3% of total flights) and private jets by 2025-2026. Potentially offsetting this are the airport's supportive regulations allowing a traffic-risk-sharing mechanism, which will entitle the company to compensation for lost revenue due to lower traffic volumes because of the lower capacity cap and the pandemic, as well as past investments.

We now have greater visibility of the recovery path, with Schiphol's passenger traffic standing at about 89% of 2019 levels for the month of July 2023. However, we believe that like other European airports, Schiphol is exposed to traffic-related disruptions due to health and safety considerations and therefore still operates in what we consider to be a moderately negative environment, which is a consideration in our credit analysis.

Issue Ratings - Subordination Risk Analysis

Capital structure

Schiphol's capital structure consists primarily of €4.0 billion of senior unsecured notes under its euro medium-term note program, plus unsecured bank loans of about €909 million. The group's total gross debt amounted to €4.9 billion as of June 30, 2023.

Analytical conclusions

We rate the unsecured debt issued by Schiphol 'A', the same as our issuer credit rating, reflecting that priority liabilities in the form of secured loans are significantly less than 50%.

Ratings Score Snapshot

Issuer Credit Rating	A/Stable/A-1
Business risk:	Excellent
Country risk	Very Low
Industry risk	Low
Competitive position	Excellent
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	a-
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	Negative (-1 notch)
Stand-alone credit profile:	bbb+
Related government rating	AAA
Likelihood of government support	Moderately high (+2 notches from SACP)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Industry Top Trends Update Europe: Transportation Infrastructure, July 18, 2023
- European Air Travel Defies Economic Pressures On Robust Demand, June 7, 2023
- Europe's Airlines To Bear Highest Carbon Costs, April 3, 2023

Ratings List

Upgraded

	To	From
Royal Schiphol Group N.V.		
Schiphol Nederland B.V.		
Issuer Credit Rating	A/Stable/A-1	A-/Stable/A-2
Royal Schiphol Group N.V.		
Senior Unsecured	A	A-
Schiphol Nederland B.V.		
Senior Unsecured	A	A-