FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms AIAS Revenue Bonds at 'A+'; Outlook Revised to Stable

Wed 05 May, 2021 - 4:22 PM ET

Fitch Ratings - New York - 05 May 2021: Fitch Ratings has affirmed the 'A+' rating on Alaska International Airport System's (AIAS) approximately $319 million of revenue bonds. The Rating Outlook for all bonds is revised to Stable from Negative. The state of Alaska owns AIAS, which operates the Anchorage (ANC) and Fairbanks (FAI) international airports, as well as the Lake Hood/Spenard Seaplane Base.

RATING RATIONALE

The revision of the Rating Outlook to Stable reflects the airport system's continued financial stability during the pandemic. Cargo performance has surged in fiscal 2021, balancing pandemic-related declines in enplanements. The airport system also benefits from a fully residual airline use and lease agreement (AUL) that allows for strong cost recovery and rate-making ability.

Feedback

The rating reflects AIAS' well-anchored cargo position and air service monopoly, supported by a modestly sized traffic base, conservative debt structure and a stable financial profile. Cargo activities have a long track record at AIAS but remain volatile in nature, which is somewhat mitigated by the airport system's stable pre-pandemic passenger enplanement base of over three million. AIAS' fully residual rate methodology results in a strong financial profile, with modest operating revenue growth, and controlled operating expenses. Its liquidity position remains strong with over 600 days cash on hand (DCOH). Leverage (net debt to cash flow available for debt service [CFADS]) remains relatively low, with a peak of 3.2x in Fitch's rating case.

KEY RATING DRIVERS

Essential Market Position - Revenue Risk (Volume): Midrange
Air travel is essential in Alaska due to a lack of alternatives, which provided a stable pre-pandemic origination and destination (O&D) base of over 3.4 million. Two major airports, Anchorage (ANC) and Fairbanks (FAI), are strategically located for air cargo along the great circle route. Cargo, which provides over half of total operating revenues, benefits from recent trends in e-commerce spending but remains exposed to volatility in economic patterns.

Favorable Rate Setting Approach - Revenue Risk (Price): Stronger
Carriers operate under a full residual operating agreement, which allows AIAS to set and adjust rates to ensure sufficient revenues for operating and maintenance, reserves and the rate covenant. The operating agreement became effective in 2014 for a period of 10 years. Cost per enplanement (CPE) was $12.39 in fiscal 2020, within the range of its peers.

Modest Capital Program - Infrastructure Development and Renewal: Stronger
The airport system's capital program of $150 million from fiscal 2021 through fiscal 2023 is funded through grants, internal reserves and approximately $5 million in bond proceeds. The largest project, resurfacing the ANC airfield, is allotted approximately $30 million per year through fiscal 2023. Terminal facilities are relatively new and in good condition.

Conservative Debt Structure - Debt Structure Stronger
The system has a conservative debt structure, with 87% of debt fixed rate, along with relatively standard covenants and reserve requirements. AIAS has a track record of accelerating its leverage reduction by using available cash to pay down debt and lower annual debt service.

Financial Profile
AIAS's healthy balance sheet helped manage financial metrics of 2.1x net debt to CFADS, $126 debt per enplanement, and 630 DCOH in fiscal 2020. The debt service coverage ratio (DSCR) in fiscal 2020 was 2.6x with PFCs included as revenues. AIAS' DSCR is expected to decrease toward the 1.25x rate covenant under Fitch's rating case over the next few years

as the airport system reduces charges under the residual airline agreements. Net debt to CFADS remains strong, between 1.5x and 3.5x in Fitch's rating case, varying as rates are adjusted and CARES Act funds decline.

PEER GROUP

Louisville (A+/Negative) and Memphis (A/Stable) airports are Fitch-rated peers with dual dependency on cargo operations and passenger traffic. Memphis has higher leverage at 10.6x in fiscal 2020 and less liquidity than AIAS.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--While positive rating action in the near term is not expected given recovery uncertainties, a continued period of positive passenger and cargo trends, coupled with leverage remaining at low levels taking into account future capital needs, could position AIAS for an improving credit profile.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--New borrowings for non-revenue-generating projects that would materially increase total leverage above the historical 5x to 7x range.

--Significant cargo and passenger enplanement volatility and material changes in internal liquidity.

--Management's inability to continue to successfully control operating costs, resulting in rising airline costs on a sustained basis.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT UPDATE

Performance Update

Air cargo is an essential component of AIAS' operational and financial strength, and Fitch expects AIAS will continue to be served by various U.S. and foreign-flag carriers. Cargo as measured by certified maximum gross takeoff weight (CMGTW) surged during the pandemic, increasing by 18% in 2021 fiscal year to date through March, compared with growth of 5% and 2% in fiscal years 2020 and 2019, respectively. Large carriers such as UPS and Cathay Pacific Airways refuel in Alaska, accounting for 14% and 13% of total CMGTW in fiscal 2020, respectively. FedEx, Atlas Air and China Airlines each has significant market share, ranging from 7% to 10%. Almost all airlines that refuel in Alaska have the ability to bypass AIAS airports, which presents a risk to cargo volumes. However, the risk is partially mitigated by certain economic advantages that stem from using AIAS for carrying more cargo as well as the investments in place by FedEx and UPS for training and cargo sorting facilities at ANC.

Enplanements decreased by 58% in fiscal 2021 year to date (through March) and 22% in fiscal 2020 due to the pandemic. The peak monthly decline of 89% occurred in April 2020. The monthly declines have steadily improved since with March 2021 monthly enplanements down 35% compared to March 2019. Alaska Airlines is the dominant carrier, accounting for 69% of enplanements in fiscal 2020. Carrier concentration is not an immediate credit concern, although sustained single-carrier dominance could pose future challenges to pass costs to passenger carriers if cargo revenue declines in future years. AIAS is historically 100% O&D because, while ANC and FAI are hubs, aviation/other alternatives are not present, which is a credit strength.

Operating revenues, comprising airfield and non-airfield revenues, decreased 3.2% to $137 million in fiscal 2020 due to the onset of the pandemic in the fourth quarter. Total revenues, including $9.9 million out of the $33.1 million in CARES Act funds and PFC charges applied to debt service of $8.5 million, increased 5.1% in fiscal 2020. The airport system plans to allocate remaining CARES Act funds and additional funds from the Coronavirus Response and Relief Supplemental Appropriation Act (CRRSAA) and American Rescue Plan Act (ARPA) from fiscal 2021 through fiscal 2023. Operating revenue in fiscal 2021 through February declined by 10.8% due to the pandemic and downward adjustments to rates facilitated by the CARES Act funding. Operating expenses decreased 5.3% in fiscal 2020, partially due to an adjustment adding back a $7.7 million non-cash pension liability re-allocation in fiscal 2019.

Although the conduit bonds issued to finance construction of the Anchorage CONRAC facility are not an AIAS liability, AIAS contributed $3.1 million of its CARES Act funds to reduce the customer facility charge (CFC) rate back to the Dec, 31, 2020 level, effective April 1, 2021. The ANC CONRAC facility increased its CFC fee by 106% on Jan. 1, 2021 due to reduced rental car volumes during the pandemic.

FINANCIAL ANALYSIS

Fitch Cases

Given the current economic environment due to the coronavirus and the unlikelihood of a stable operating environment over the near term, Fitch's rating case is also considered the base case. Fitch's rating case assumes, relative to fiscal 2019, a 52% decline in enplanements in fiscal 2021, followed by declines of 25%, 15% and 5% in fiscal years 2022, 2023 and 2024, respectively. Enplanements reach full recovery in fiscal 2025. Airline payments are driven by cost recovery terms under the rate agreements and adjusted by CARES Act funding for costs and non-aeronautical revenues are largely driven by fluctuations in passenger traffic. Under Fitch's rating case, the DSCR declines to 1.3x in fiscal 2025 as rates are reduced toward the rate covenant of 1.25x. CPE is approximately $12 in fiscal 2021 and remains below $10 from fiscal 2022 through fiscal 2025. Fitch also assumes that the airport system will proceed with a refunding for debt service savings in the near term.

Fitch also ran a severe downside case with declines relative to 2019 of 50%, 35% and 20% in fiscal years 2022, 2023 and 2024, respectively, and full recovery in fiscal 2025. Under this scenario, the DSCR and leverage profiles are the same as the rating case given the fully residual AUL, but there are higher values for CPE. The maximum CPE is approximately $14 in fiscal 2021.

Feedback

SECURITY

The bonds are secured by a pledge of net airport system revenues. The state also applies PFC funds to pay debt service.

Asset Description

The State of Alaska owns AIAS, which operates Anchorage (ANC) and Fairbanks (FAI) international airports as well as the Lake Hood/Spenard Seaplane Base. ANC is the primary passenger airport in the state and is an important international cargo airport. FAI is an essential transportation and distribution center for interior and northern Alaska.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Alaska International Airports System (AK)		

ENTITY/DEBT	RATING			PRIOR
• Alaska International Airports System (AK) /Airport Revenues/1 LT	LT	A+ Rating Outlook Stable	Affirmed	A+ Rating Outlook Negative

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Infrastructure and Project Finance Rating Criteria (pub. 24 Mar 2020) (including rating assumption sensitivity)

Airports Rating Criteria (pub. 22 Oct 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

GIG AST Model, v1.3.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

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Endorsement Policy

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