FitchRatings

Tagging Info

Fitch Affirms Alaska's International Airport System Rev Bonds at 'A+'; Outlook Stable

Ratings Endorsement Policy

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Fitch Ratings-San Francisco-15 August 2014: Fitch Ratings has affirmed the 'A+' rating on the State of Alaska's Alaska International Airport System (AIAS, or the system) approximately $551 million of revenue bonds. The Rating Outlook for all bonds is Stable.

The rating reflect AIAS's strong market position for cargo activities, a monopoly for air service within the state albeit supported by a modestly sized traffic base, conservative debt structure, and management's continued prepayment of debt. Cargo volume continues to exhibit volatility but is somewhat mitigated by a more stable enplanement base of 2.9 million, modest operating revenue growth, and flat operating expenses. AIAS's liquidity position remains strong with 528 days cash on hand (DCOH) while leverage is elevated for its rating level at 9.7 times (x).

KEY RATING DRIVERS

Revenue Risk - Volume: Midrange

Strong Market Position: Air travel is essential in Alaska due to a lack of alternative forms of transportation, which provides a stable origination & destination (O&D) base. AIAS operates the state's two major airports, Anchorage International (ANC) and Fairbanks International (FAI), both of which are strategically located for air cargo activities along the great circle routes. As a result, cargo revenue comprises the majority of AIAS's revenue but is vulnerable to global economic conditions as well as changes in trade policy and fuel costs.

Revenue Risk - Price: Stronger

Favorable Rate Setting Approach: Carriers operate under a full airport system residual operating agreement enabling AIAS to set and adjust rates to ensure sufficient revenues to pay operating and maintenance expenses, fund reserves, and satisfy the rate covenant. The current operating agreement that was set to expire at the end of fiscal 2013 has been renewed for an additional 10 year term under similar strong cost recovery terms. The cost per enplanement (CPE) was approximately $9.62 in fiscal 2013, which puts AIAS slightly above its peers, although airline costs have been mostly stable in recent years.

Infrastructure Development & Renewal: Stronger

Modest Capital Program: The airport has a modest $197 million capital program through 2017 with no major projects planned due to the relatively new terminal facilities. The current capital plan is funded via a combination of grants and paygo, and no additional debt is currently anticipated. The program is primarily focused on routine maintenance of the ANC airfield and equipment between ANC and FAI.

Debt Structure: Stronger

Conservative Debt Structure: The system has a reasonable amount of debt outstanding given its size with no additional debt currently anticipated. Over 90% of AIAS's outstanding debt is fixed rate. In recent years AIAS has used available cash to pay-down debt thereby lowering annual debt service, and AIAS maintains this option in the future.

Sound Financial Metrics: AIAS's healthy balance sheet helps to manage the financial metrics: net debt/cash flow available for debt service: 9.7x; debt per enplanement: $187; days cash on hand: 528. Fiscal 2013 debt service coverage was 1.33x with the debt pay-down from the construction fund. Without factoring in the debt pay down coverage would have been 1.01x.

RATING SENSITIVITIES

Negative - Significant volatility in cargo and passenger enplanement activity and material changes in the system's internal liquidity could pressure the rating.
Negative - Management's inability to continue to successfully control operating costs and resulting in narrower financial margins. Also, ongoing use of cash funds to cover annual debt service requirements may impact the balance sheet strength.
Negative - While not contemplated for some time, a revised capital program with increase in borrowings may pressure the rating.

Positive - None considered at this time.

Peer Group

Closest peers are Louisville and Memphis, rated 'A+' and 'A', respectively, based on dual dependency on cargo operations and passenger traffic.

CREDIT UPDATE

Air cargo operations are central to AIAS's operational and financial strength and though performance can be volatile, Fitch expects AIAS's strategic location will result in continued significant activity. Cargo activity rebounded strongly following the economic downturn, with gross takeoff weight growing 15.6% and 5.9% in fiscal 2010 and 2011, respectively. Cargo activity pulled back by 10.9% and 5% in fiscal 2012 and 2013 respectively. Cargo activity continues to be impacted by increased marine competition and uncertainty regarding global economy. AIAS expects relatively modest annual cargo growth at approximately 2% over the next several years.

In comparison to cargo, passenger enplanements have exhibited more stability over time. Over the period 2003 to 2013, the airport system grew at a rate of 1.23%. Fiscal 2013 enplanements declined 0.5% following modest growth of 1.2% in fiscal 2012. Enplanements had grown for six straight years prior to downturn-driven declines in fiscal years 2009 and 2010. Based on preliminary numbers, Fitch expects fiscal year 2014 enplanements to be modestly above fiscal 2013.

Carrier concentration remains high with Alaska Airlines servicing 59% of traffic at the airports in fiscal 2013, up from 44% in fiscal 2006. While air carrier concentration is not a meaningful credit concern at this time, a sustained level of single-carrier dominance could pose future challenges for the system to pass on costs to passenger carriers to cover any adverse developments related to cargo revenues in future years.

Fiscal 2013 operating revenue was $107.9 million, up 1% from fiscal 2012. Continued softness in cargo activity was offset by increased concession revenue due to increased concession offerings. The airport's cargo component accounted for approximately 51% of total operating revenues in fiscal 2013. Operating expenditures were flat in fiscal 2013 due in part to reductions in field maintenance, facilities, and other expenses partly as a result of a milder winter relative to the previous year. Fiscal 2013 audited financials show unrestricted cash of $115 million, representing 528 DCOH.

Debt service coverage for fiscal 2013 was 1.33x applying bond document calculations. As in fiscal years 2011 and 2012, the coverage level is influenced by the system's continued use of excess construction fund cash to pay down debt. Without the use of excess cash, fiscal 2013 coverage would have been just above 1x.

Given its large cash balance AIAS retains the option to use available cash to lower future-year debt service. In June 2014, AIAS paid down additional debt of approximately $36 million. Given the large pay down, Fitch expects the system to continue to meet the minimum 1.25x debt service coverage ratio under the rate covenant in future years with less reliance on the continued use of reserves absent a boost in operating revenues driven by growth in cargo and enplanement activities or through upward adjustments in airline fees and charges.

The airport's modest capital improvement plan spanning fiscal years 2013-2017 totals $197 million and is primarily focused on airfield pavement reconstruction at ANC and equipment needs at the two airports. The projects are funded through increased rates and charges, federal airport improvement program grants (AIP), and available cash. No future borrowing is currently anticipated. Under Fitch's base case scenario which assumes 4.2% compound annual growth (CAGR) in operating revenues and 5% CAGR in operating expenses, coverage averages 1.29x over the 2015 - 2019 period. In fiscal 2018, coverage is projected to be 1.24x, just below the 1.25x covenant. In Fitch's rating case, operating revenues and expenses are projected to grow at 3% and 4%, respectively. Assuming airline revenues remain at approximately 26% of total revenues, CPE would need rise to $12.30 in 2019.

SECURITY

The bonds are secured by a pledge of general airport revenues.

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Applicable Criteria and Related Research:
--'Rating Criteria for Infrastructure and Project Finance' (July 11, 2012);
--'Rating Criteria for Airports' (Dec. 13, 2013).

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Rating Criteria for Airports

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