



# FITCH AFFIRMS RYANAIR AT 'BBB+'; OUTLOOK STABLE

News / Finance



**Fitch Ratings** has affirmed **Ryanair** Holdings plc's (RYA) Long-term Issuer Default Ratings (IDR) and Ryanair Limited's senior unsecured rating at '**BBB+**'. The Outlook on the IDR is Stable.

The unsecured rating covers EUR1.7bn of debt, and it is aligned with RYA's IDR of 'BBB+' despite potential subordination to RYA's approximately EUR2.7bn of secured debt. Since mid-2014, RYA has been shifting to unsecured debt from secured debt and we expect this trend to continue. Secured debt to EBITDA decreased to below 2x as of FYE15, a level that we associate as linked with high likelihood of subordination. In addition, our estimate of unencumbered assets to unsecured debt ratio supports the alignment of the unsecured rating with the IDR.

## KEY RATING DRIVERS

Cost Leadership

RYA's low cost advantage and substantial liquidity are key drivers of its rating. The company's

high margins, significant cash generation, financial flexibility, and access to the unsecured debt markets further differentiate RYA from many airline peers. RYA's solid capacity for meeting its financial commitments is also supported by the company's fairly flexible cost structure, low break-even load factor, and robust hedging programmes for fuel and currencies.

#### Net Cash Position

The company's low fleet age, fleet commonality and other elements of its business model further support the ratings. RYA's financial metrics are generally strong for the rating, with the exception of gross leverage, but this is offset by low net leverage metrics driven by the company's large cash position.

#### Business Model Mitigates Industry Risks

Overall, RYA's conservative and simplified business model tempers the impact of gross financial leverage and operating leverage that are characteristic of the airline industry. The business model is designed not just to achieve industry-low costs, but also to mitigate some of the key risks in the sector. The company's financial strength, including strong cash liquidity, is a key element of this low-cost/reduced-risk strategy. RYA's leading cost position, liquidity, high margins and significant cash generation give it the ability to withstand the inevitable shocks that periodically hit the airline industry, as well as fending off competitive threats.

#### Cash Distributions, Competition Pose Risks

Key rating risks include significant cash distributions to shareholders and potential yield weakness if competitors use lower fuel costs to fund fare cuts. RYA's revenue profile is also more seasonal than most of the airlines in Fitch's portfolio, although some business model changes, such as more focus on business travellers, could mitigate this. Competitive pressures are a persistent challenge, including expansion plans of various low-cost/hybrid airlines, such as easyJet plc and Norwegian Air Shuttle ASA and a gradual unbundling trend at the legacy carriers.

#### Expansion Plans

The company's growth plan and related capital expenditures over the next five years is an item to watch, as is potential longer-term exposure to fuel price levels and currency exchange rates. Larger changes to the company's business model, such as an expansion into the long-haul market (unless credit ring-fenced in a separate entity from RYA), could also be a rating risk. Fitch believes the risk of a long-haul operation has lessened in the past year as a result of some clarifying comments from RYA, but continues to monitor this possible business change. Other risks for the general airline industry include economic downturns, debt market conditions, fuel price shocks, war and terrorism, disease pandemics, and environmental factors such as volcano ash clouds.

#### Strong Free Cash Flow

RYA's performance in the past year has been ahead of Fitch's forecasts, but this has been partly offset by the announcement of a share repurchase programme earlier than Fitch had expected. In FY15 RYA's revenues rose 12%, while margins increased five points. This performance compares with Fitch's conservative forecast of flat revenues and a modest margin decline for FY15. RYA's free cash flow (FCF) in FY15 improved to EUR901m compared with EUR539m in FY14 despite higher capex (EUR789m vs. EUR506m). Fitch expects strong FCF in FY16 despite a continued increase in capex.

#### Increasing Capex

Fitch expects capex will remain elevated for the next five years. We previously expected capital spending would peak in FY17 or FY18, but the order in 2014 for up to 200 Boeing 737 MAX 200 aircraft (100 firm orders plus 100 options) will extend this by several years. Fitch continues to forecast RYA will be able to maintain positive FCF throughout this period of heavy capital

spending, although FY19 FCF could be low as both the existing aircraft order for 183 737-800 planes and the new MAX 200 order will drive spending in that year. If cash flow or liquidity came under pressure, Fitch expects Ryanair will temporarily reduce cash deployment to shareholders.

#### Substantial, but Flexible Equity Returns

RYA has distributed a substantial amount of cash to shareholders over the past six years, and Fitch expects shareholder cash deployment will continue over the next few years assuming no material disruptions to RYA's business. The company indicates that shareholder distributions are subject to continued profitability, the economic environment, capital expenditure, fuel prices, yields and shareholder approval. The company issued a EUR520m special dividend on 27 February 2015 and also completed a EUR400m share repurchase, EUR112m of which was completed at the end of FY15. While Fitch's forecasts included substantial shareholder returns, this share repurchase programme was implemented earlier than expected, increasing the risk that overall FY16 shareholder cash deployment could exceed Fitch's expectations if an additional repurchase or dividend programme is announced later in FY16. The company will also apply most of the proceeds from its sale of Aer Lingus shares to shareholder disbursements.

#### High Hedging Position

Fuel and currency volatility is a key issue in the global airline sector in 2015. RYA continues to address this volatility to a greater extent than its peers, with both fuel hedged 90% for FY16 and 70% for FY17. Capex is fully hedged through FY18. While its hedging policy provides the company with cost certainty, RYA faces a risk that its peers with fewer or no hedges will be able to use the fuel price windfall to lower fares. The strong US dollar partly offsets this risk, but fare pressure is an item to monitor in FY16.

#### Increased Customer Focus

Since 2014 Ryanair has made some modifications to its business model, and others are in progress. Its goal is to increase its customer satisfaction while keeping its low-fare focus, lifting load factors, and modestly raising average fares. Fitch believes many are common sense moves, and the net cost appears modest. To date, most of these modifications have been a success, and if the momentum continues, financial performance could be further boosted over the next two years.

#### Steady Gross Leverage

Some key credit metrics improved at FYE15 despite higher debt levels. Leverage (both adjusted debt to EBITDAR and FFO adjusted leverage) was approximately 3.5x-3.7x compared to 3.6-3.7x at FYE14. Leverage was flat driven by the strong sales and margin performance despite higher debt levels. FFO fixed charge coverage rose to 7.9x in FY15 from 5.9x in FY14.

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