What Investors Want to Know: Mexico City Airport Trust

New Risks Mount for an Asset Already Under Pressure

Traffic, Collection and Transparency

The Mexico City airport has been controversial for decades, but has been even more prominently in the public eye since late 2018, when the new federal administration cancelled the construction of a facility to be built in Texcoco, and replaced it with a three-airport system plan that includes refurbishment of the existing building.

Fitch Ratings downgraded the airport trust's rating twice since 2018: in December 2018, due to lower growth prospects and potential cost increases in operating the existing airport; and in April 2020, following the downgrade of Mexico's sovereign ratings, as the airport is a government-related entity (GRE).

As of April, the rating retained a Negative Outlook to reflect likely pandemic-related traffic declines and the ongoing uncertainty about other key credit issues posed by the Texcoco airport's cancelation.

Fitch placed the trust's 'BBB–' rating on Rating Watch Negative (RWN) in July 2020 to reflect the possibility that liquidity within the Mexico City airport trust could rapidly erode and jeopardize the airport's capacity to honor its obligations in the next 9–12 months if volume and revenue collection continue to deteriorate. The RWN also reflects Fitch's concerns regarding the issuer's lack of transparency in disclosing operational and financial information.

Questions from Investors

Investors asked Fitch to discuss the several credit risks the Mexico City Airport Trust faces amid the coronavirus pandemic:

Related Research

Fitch Places Mexico City's Airport Trust Sr. Secured Notes on Rating Watch Negative (July 2020)

Coronavirus Stress Test: LatAm Airports (Airports with Amortizing Debt Pressured the Most in Stress Scenarios) (June 2020)

Fitch Takes Further Actions on Latin American Airports (April 2020)

Fitch Updated Coronavirus Scenarios for Latin American Airports (April 2020)

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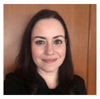

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What Is the Time Frame to Resolve the RWN?

The time frame for the RWN resolution is uncertain. It depends on when Fitch is able to form a sufficiently educated opinion on likely volume declines and recovery to 2019 levels, and gain increased visibility on the behavior of the revenue collection rate and the issuer's planned actions to reverse the trend.

The RWN will be resolved once financial and operational information provided by the issuer and trustee is sufficient to support a comprehensive analysis. While this largely depends on the efforts the issuer may make to improve its financial transparency, a significant recovery in the transaction's cash flows could reduce the need for highly detailed data, thus increasing Fitch's tolerance to a less than ideal reporting process.

According to Fitch's policies, a Rating Watch, with a few exceptions, must be reviewed by a rating committee and a Rating Action Commentary (RAC) must be published within six months of the Rating being placed on Rating Watch. Thereafter, the Rating Watch must be reviewed by a rating committee at least every six months until the Rating Watch is resolved.

The RWN could be resolved before January 2021 if circumstances warrant it. The RWN can likewise be maintained if, by the time the review is performed, Fitch believes the factors that triggered the Watch have not been resolved.

Is the Lack of Transparency a New Factor? How Much Did it Influence the RWN?

The quality of information disclosed by Grupo Aeroportuario de la Ciudad de Mexico (GACM) started to deteriorate over the last few years. Fitch did not raise this point previously because the information received, while less than ideal, was considered sufficient to reasonably allow us to perform our analytical job.

Now that the airport's operations are highly stressed due to the pandemic and lags in Tarifa de Uso de Aeropuerto (TUA) revenue collection from airlines are a new risk factor, increased visibility of issuer statistics and account movements and balances are vital to having a complete understanding of the situation. Fitch conveyed to GACM's management and the transaction's trustee its concerns related to the quality of financial disclosure with respect to its timeliness, level of detail and scope of information, but was informed by management that they are prevented from providing more detailed information due to legal constraints.

The quality of information received, both quantitative and qualitative, can be a constraining factor for ratings. Information quality may constrain the rating category to a maximum level, or in extreme cases, preclude the assignment of a rating. Information quality encompasses such factors as timeliness and frequency, reliability, level of detail and scope.

What Could Trigger a Downgrade? Is there Potential for a Multinotch Downgrade?

The notes' rating could be downgraded upon the occurrence of one or more of the following:

- A downgrade on Mexico's Issuer Default Rating (IDR) (BBB–/Stable), given the issuer's linkage to the sovereign as a GRE;
- Traffic reduction in 2020 greater than 60% and/or the expectation of a slower than anticipated recovery;
- Stabilized net debt/cash flow available for debt service ratio sustainably and materially above 10.0x;
- The perception that the revenue-collection rate will remain significantly below historical figures;
- Persistence of less than adequate disclosure of the project's financial and operational data.

Apart from movements in the sovereign rating, the materialization of any of the other events listed above would directly affect GACM's standalone credit profile (SCP). The number of notches in which the SCP would be downgraded would depend on the magnitude of the deterioration in the issuer's credit quality.

Given GACM's status as a GRE, Fitch also applies its Government-Related Entities Rating Criteria, which acknowledges the likelihood of potential government support. In the case of GACM, Fitch's assessment of potential government support (score of 20 points according to Fitch's criteria) provides room for the SCP to be downgraded up to three notches to 'bb–' from 'bbb–', with the transaction rating only being downgraded one notch to 'BB+' from 'BBB–'.

However, a downgrade in the SCP to below 'bb–' and/or the weakening of Fitch's perception regarding potential government support could effectively result in a multinotch downgrade of the notes' 'BBB–' rating. The assessment of governmental support is dynamic, and when it is weak or moderate, the primary driver of the GRE's rating is its SCP.

Fitch's analytical approach for GREs combines an analysis of the SCP and the likelihood of exceptional support in the event of financial difficulties at the GRE. In assessing the likelihood of support, Fitch considers two key rating factors: Strength of Linkage and Incentive to Support, each of which is divided into two subfactors.

Each factor is assessed with a prospective bias as 'Weak', 'Moderate', 'Strong' or 'Very Strong', and each level of assessment is associated with a score. An overall score is obtained by adding the individual scores and used to derive the IDR of the GRE via a tabulated notching approach. Fitch differentiates between the levels of support likely to be available by determining whether support is highly probable (top-down approach) or possible (bottom-up approach).

What Are Expectations for Sovereign Support ?

Fitch believes the Mexican government has incentives to support the airport. As the main gateway to the city and the country, it is an essential asset, which significantly increases the likelihood of receiving government support.

However, Fitch does not count on any cash injections by the Mexican government into the transaction. The possibility of having the government making financial contributions to GACM is highly uncertain, especially now that federal finances are tight amid the coronavirus pandemic and the beginning of a severe recession.

The government may nonetheless be able to support GACM in ways other than monetarily. It could apply extraordinary increases on the TUA, as the concession title framework combined with the fact that both concessionaire and grantor are government owned provide ample legal flexibility to adjust tariffs when necessary. The government could also assist GACM in negotiations with airlines related to accounts receivable collections that accumulated in recent months.

The government demonstrated support for the transaction in July 2020, when GACM decided not to distribute approximately USD75 million of the transaction's remnants and keep them inside the trust. This strengthened the transaction's liquidity for the benefit of the bondholders.

The government could support the airport through other actions, such as condoning taxes, subsidizing administrative/operational activities or assisting GACM in raising additional debt. However, these would not be beneficial to the rated transaction, at least not directly.

In assessing the likelihood of support, Fitch gives more weight to the Incentive to Support subfactors (sociopolitical and financial implications of default) than to the Strength of Linkage subfactors (status, ownership and control, and support track record and expectations).

What Is the Problem with Revenue Collection? What Are Expectations for Existing Accounts Receivable?

TUA revenues received by the trust are much lower this year than in previous years, mainly due to the traffic decline triggered by the pandemic, but also as a result of significant collection lags.

The TUA is charged to each flight ticket when sold, so airlines collect it and must transfer it to the trust. The airport manages different commercial terms with each airline, ranging from 30 to 120 payment days. However, some airlines failed to make timely transfers since the beginning of this year, adding pressure to the trust's cash flow. TUA never passes through GACM's accounts, as it goes directly from the airlines to the trust.

GACM does not report revenue figures, only traffic, but Fitch makes its own calculations to estimate the figures based on the public volume data and TUA prices. The calculation is an approximation, as not all passengers pay TUA (e.g. children) and traffic data, as disclosed by the issuer, does not show the exact number of passengers actually paying TUA. Fitch estimates approximately 37% of total passengers using the Mexico City airport pay TUA.

When the quarterly debt service coverage ratio report was released by the trustee on June 12, 2020, Fitch noted the revenues deposited into the trust were around 30% less than anticipated, suggesting revenue underperformance was not only due to traffic behavior but also to deteriorated collection. GACM later provided the amounts of collected TUA indicating the revenue collection worsened in recent months.

Fitch believes future performance of collection days and the eventual recovery of the accounts receivable will depend on each airline's opted course of action and financial situation, as well as potential strategies GACM may implement. It is not possible to know the composition of the accounts receivable by obligor and age just by using the public information available. However, we estimate around two-thirds relate to local airlines Aerovias de Mexico (Aeromexico) and ABC Aerolineas (Interjet). Given Aeromexico initiated bankruptcy proceedings in July 2020 and Interjet has had financial difficulties since at least 2019, the normalization of such accounts could likely take several months.

Why Do You Assume Only 37% of Passengers Pay TUA? Do You Believe This May Change Significantly?

As published in the official journal of the federal government (Diario Oficial de la Federacion), TUA is to be paid by all national and international passengers departing from the Mexico City airport. Passengers exempt from paying TUA are:

- Children under two years old;
- Diplomatic staff from other countries in case of reciprocity;
- Transit and connecting passengers;
- Aeronautical personnel during their service.

The 37% assumed by Fitch is based on 20 years of observations from 1999 to 2018, in which this percentage was very stable, ranging from 35.3% in 2008 to 40.8% in 1999, with an average of 37.9% and median of 37.7%. Fitch has not received 2019–2020 data, and while the airport reports passenger numbers for arrivals and departures, it is not possible to infer how many of them are connecting or not connecting, adults or children, etc. We therefore use the historical 37%, and corroborate it with a rough calculation based on information available.

It is possible the 37% could change if travel patterns change, particularly if departing traffic declines more than arrivals, as only departing passengers pay TUA.

How Did You Calculate Available Liquidity? Did You Consider Cash Reported on the 1Q20 Balance Sheet?

Fitch stated in a RAC published July 7, 2020, "the trust has kept liquidity equivalent to more than 3x the upcoming payment amount." We were referencing the July 31, 2020 coupon of USD60.1 million, and our calculation of liquidity available within the trust was around USD180 million. However, the last balance sheet available at that time, as of March 31, 2020, showed cash, cash equivalents and restricted cash of around USD570 million (MXN12.8 billion).

When calculating available liquidity, Fitch considers only the resources that can be effectively used to pay debt service, excluding any distributable/unrestricted cash or cash destined for operational requirements. Fitch cannot assume all the reported cash can be automatically used to pay debt service because the cash management of this transaction is ruled by the accounts' definition of a trust.

We asked GACM to provide the breakdown of the cash within the trust, but did not receive it. However, we estimated how most of the USD570 million was distributed based on public information and our understanding of the transaction's structure:

Fitch-Estimated Account Balances

(USD Mil., as of March 31, 2020)	
Principal Accumulation Account	250
Debt Service Reserve Account	111
Several Excess Cash Accounts	75
TUA Revenue February and March[a]	60
VAT TUA Revenue	16

[a]January revenues are not considered as they should have been used to pay the Jan. 31, 2020 coupon. GACM – Grupo Aeroportuario de la Ciudad de Mexico.
TUA – Tarifa de Uso de Aeropuerto.
Source: Fitch Ratings, GACM, the trustee.

The amounts shown in the table above add USD512 million and represent about 90% of the reported cash balance. These numbers are approximated and can also vary due to MXN/USD exchange rate movements.

Out of the USD512 million, only the debt service reserve account and the monies trapped in several excess cash accounts — a total of USD186 million — can be used to pay debt, in addition to any further TUA revenues the trust could receive.

The remaining USD58 million could represent cash reserved for trust expenses, 2019 accumulated VAT or other items. Fitch will not give credit to those resources unless it is confirmed they are in a debt service dedicated account.

Can the Airport Tap into the Principal Accumulation Accounts to Pay Debt Service?

The resources in this account cannot be used to make debt service payments. Section 4.05 (c) of the restated indentures of the notes dated December 2018 states the funds deposited in the principal accumulation account may be withdrawn to be applied only to:

- Invest in U.S. dollar permitted investments;
- Fund the repayment of the notes at their stated maturity and repurchases of the notes, which may be made by open market repurchases, tender offers or otherwise;
- Defease indebtedness under the notes as permitted under the indenture.

The last bullet refers to the use of the balance of the principal accumulation account in the calculation of the senior secured debt, not to the possibility of an actual withdraw.

However, the cash in this account could be given a different use only if the respective indentures are amended, which requires the consent of at least a majority of the bondholders.

What Are Fitch's Rating Case Assumptions? Are They Aligned with Other Airports?

Fitch developed a revised coronavirus rating case and sensitivity scenarios for Latin American airports in April 2020 to reflect airlines' and governments' decisions, and the greater than anticipated reductions being experienced in passenger traffic of around 80% or higher across most airports in the region. These scenarios incorporate the increased concern that the impact on air travel from this health crisis will be deeper and more prolonged than initially thought, and combined with the resulting effects on the region's economies, will cause a less robust recovery that may extend beyond 2022.

Even with early discussions underway for limited re-openings of national or local economies, a return to a more normalized air travel environment remains unclear.

Fitch differentiates the pace of traffic recovery between airports assessed as 'Stronger' and 'Midrange' on volume risk to account for differences in their abilities to weather the effects of macroeconomic and event stresses on activity. GACM's volume risk is assessed as 'Stronger'.

Fitch's main rating case assumes the following:

- Traffic variation versus the same period of 2019 are negative 75% in 3Q20, negative 60% in 4Q20 and negative 60% at the end of 2020. Traffic is negative 15% in 2021, not reaching 2019 levels until 2022. No further growth is assumed from 2023 onward given the airport facility was already congested in 2019.
- Traffic mix for 2020 is 80% national passengers and 20% international passengers. The historical mix of 65% national and 35% international is assumed for 2021 and beyond.
- TUA collection for 2020 is 80% received by the trust. For 2021 and beyond, 100% will be collected. No recovery of unpaid TUA is assumed given the time frame of that potential recovery is highly uncertain at this time.

The assumptions in Fitch's rating case for GACM and the rest of the Latin American rated airports are aligned with those used in the analysis of Fitch's global airport portfolio. This means they follow the same logic and overall trends, but are not exactly the same, because each market is unique. The exposure of each project to particular risks and the expected pace of recovery are therefore also different.

Are You Concerned About Other Key Risks That Drove the Pre-Pandemic Negative Outlook?

The pandemic-related effects on the airport's performance and payment capacity became the focus of our analysis to establish their impact on the airport's medium-term credit profile. However, ratings also continue to reflect concerns about other key credit issues highlighted since December 2018, which may affect the airport credit profile over the longer term if not addressed.

The airport's currently low traffic makes the following issues less pressing, at least in the short term:

- The lack of a viable business strategy to address Mexico City's air transportation needs;
- The possibility of solving these needs through three airports and uncertainty about airlines' reactions;
- Potential deterioration of the asset quality in the absence of material capital investments.

Another concern Fitch raised was the deterioration in the airport's future pricing power, as the TUA is now earmarked to repay a stranded financial obligation instead of a capital-improvement project. Fitch believes the airport continues to be exposed to this risk, which could become relevant if GACM plans to apply extraordinary TUA increases to strengthen its debilitated cash flow.