FITCH AFFIRMS MEMPHIS AIRPORT GARBS AT 'A'; OUTLOOK STABLE

Fitch Ratings-San Francisco-12 August 2016: Fitch Ratings has affirmed the 'A' rating on Memphis-Shelby County Airport Authority, Tennessee's (the authority) outstanding $282 million general airport revenue bonds (GARBs). The Rating Outlook is Stable.

The rating is supported by Memphis International Airport's (the airport) small but nearly 100% origin and destination (O&D) traffic base, moderate carrier diversification, and the presence of Federal Express' (FedEx) massive cargo operations, which helps to mitigate passenger volume declines. Although Delta's recent de-hubbing resulted in substantial enplanement losses and higher cost per enplanement (CPE) in the $13 range, leverage is relatively moderate under 2x, and the residual nature of the Airport Use and Lease (AUL) agreement helps maintain a minimum debt service coverage within the A category.

KEY RATING DRIVERS

Revenue Risk- Volume: Midrange
O&D Airport with Sizeable Cargo Operations: The airport benefits from moderate carrier diversification, limited competition from other airports in the region, and a nearly 100% O&D traffic profile. Delta's de-hubbing of the airport is substantially complete, and Fitch expects minor enplanement growth moving forward based on O&D market growth and positive carrier capacity trends. Passenger volume risks are mitigated by the long-term and expansive presence of Federal Express (FedEx) cargo operations, which make up about 90% of the airport's total landed weight

Revenue Risk- Price: Midrange
Residual AUL with High CPE: Fitch views positively the airport's fully residual AUL, renewed through fiscal 2017, enabling it to fully recover net operational costs from carriers. Recent years' substantial enplanement losses more than doubled CPE to $13.34 in fiscal 2015, which is high for a small airport but has not yet meaningfully deterred airlines from launching new routes or maintaining existing ones.

Infrastructure Renewal and Development: Stronger
Historically Manageable CIP: The airport's capital needs historically have been manageable with no debt financing needs. The current capital improvements plan (CIP) is sizeable totalling $417 million and includes a major concourse modernization project along with various airfield and warehouse upgrades. The authority does expect to issue additional debt to fund the CIP, and has met extensively with current airlines to notify them accordingly.

Debt Structure: Stronger
Conservative Debt Structure: The airport's debt is 100% fixed rate, fully amortizing, and steps down in stages through maturity. The debt service reserve fund is sized to the maximum allowed by the IRS and is predominantly cash-funded.

Low Debt with Stable Financial Metrics
The airport benefits from low leverage levels, with unaudited actual fiscal 2016 net debt to cash flow available for debt service (CFADS) of 1.72x. As is consistent with many small hub airports that use residual AULs, the debt service coverage ratio (DSCR) is generally constrained, resulting in the airport's 1.34x coverage (1.08x excluding a rolling coverage account); however, DSCR tends to be quite stable.

Peers
Louisville ('A+'/Stable Outlook) and Indianapolis ('A'/Stable Outlook) are comparable to Memphis given their large cargo operations, with Memphis benefitting from the largest presence. Louisville's higher rating level reflects significantly lower CPE levels and stronger financial metrics. Indianapolis exhibits lower carrier concentration and a larger O&D base than Louisville, though these advantages are offset by higher leverage levels.

RATING SENSITIVITIES

Negative: Sizeable bond issuances above Fitch's expectations may lead to negative rating action.

Negative: A significant CPE increase from already high levels (as defined by committee), leading to a demonstrable loss of competitiveness, or a sustained decrease in DSCR below 1.25x.

Negative: A material and sustained reduction of the airport's O&D enplanement base or cargo volumes.

Positive: Due to recent years' substantial deterioration of the airport's enplanement base and CPE, Fitch views positive rating action over the short-to-intermediate term as unlikely.

SUMMARY OF CREDIT
The airport's enplanement base recovered in fiscal 2016 for the first time in six years, growing to 1.97 million from 1.79 million the year prior (a 9.8% gain). Enplanements fell 8.5% in fiscal 2015 and are down a substantial 62% from fiscal 2008, predominantly reflecting Delta's decision to de-hub the airport. The de-hubbing process was substantially completed in fiscal 2015. As a result, Delta's market share fell to a moderate 34% in fiscal 2016 from a concentrated 77% as recently as fiscal 2013.

Fitch now expects enplanement levels will likely stabilize and grow modestly based on expectations of continued yet measured O&D growth following two consecutive years of O&D gains. Also, carriers have been backfilling routes cut by Delta and have been increasing capacity by up-gauging aircraft. Despite expectations of modest growth, management is conservatively projecting a small enplanement decline in fiscal 2017 followed by no growth through its five-year forecast. Fitch views the airport's enplanement projections as prudent for budgeting purposes and has included them in the base case projections below.

While enplanements have declined dramatically in recent years, the presence of FedEx balances the airfield operations of the airport and provides some cushion, which makes the airport unique from other airports that have been de-hubbed. Memphis has been the worldwide leader in air cargo tonnage throughput most of the past twenty years. Total enplaned cargo increased 1.4% in fiscal 2015 to 4.7 billion pounds from 4.6 billion the year prior. The lease agreement with FedEx runs for 30 years from 2007 with two 10-year renewal options. FedEx accounted for about 99% of total cargo volume at the airport in fiscal 2015, and has represented at least 92% of such activity since fiscal 1992.

The authority's five-year AUL expires in June 2017 and signatories include every major passenger and cargo airline. The extension of the agreement in the midst of the Delta de-hubbing suggests airlines are willing to tolerate rising CPE through the 2017 AUL expiration, at which point debt service will drop by $12.8 million and CPE will drop in lock-step.

The authority's sizeable five-year CIP, which totals $417 million, will include a major terminal modernization project as well as large airfield improvements. The airport expects additional public and private debt issuances sometime in 2017 (FY2018), which totals an estimated $140 million.

Fiscal 2015 operating revenues decreased to $100 million from $113 million the year prior, reflective of lower airfield and terminal rental income. Unaudited fiscal 2016 financial performance was much improved, with revenues growing 6% and expenditures increasing just 2.5%.

Debt service coverage of 1.42x (1.17x excluding a rolling coverage account) in fiscal 2015 was lower than prior year expectations. Unaudited actual financial performance for fiscal 2016 points to a slightly lower DSCR of 1.34x (1.08x). The authority projects coverage of 1.25x (inclusive of a rolling coverage account) moving forward as is consistent with the residual nature of the AUL. Cash levels have generally increased over the past several years and, at 272 days cash on hand in 2015, and 280 days in 2016. Fitch considers cash levels to be sound for the rating level.

Fitch's base case scenario is derived from the authority's projections, which incorporate conservative enplanement projections noted above and a high 3.5% expenditure growth rate from fiscal years 2016 - 2021. Fitch expects CPE to remain in the $12-$13 range, though the authority calculates that CPE will fall to below $10 in fiscal in the coming years, due to declining debt service, and will increase modestly thereafter. Maximum leverage (net debt to CFADS) is projected at 2.43x in fiscal 2017 and drops to lower levels thereafter.

The airport's financial metrics hold up adequately under Fitch's rating case scenario, which assumes a hypothetical recessionary 10% enplanement loss in fiscal 2017 followed by 2% annual growth through the remainder of the forecast period. Fitch also incorporated the estimated $140 million in additional debt issuances in fiscal 2018. Under this scenario leverage would peak at a maximum of 3.61x in 2018, and decline over time. Due to the additional debt service requirements, Fitch-calculated CPE would rise to a peak of $16.41 in fiscal 2018 and decline thereafter. Fitch notes that the authority uses a different basis to calculate CPE that would have resulted in a moderately lower CPE ratio under Fitch's rating case.

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Applicable Criteria

Rating Criteria for Airports (pub. 25 Feb 2016)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=877676

Rating Criteria for Infrastructure and Project Finance (pub. 08 Jul 2016)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=882594