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Summary:
Memphis-Shelby County Airport Authority, Tennessee; Airport

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Summary:

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Credit Profile		
Memphis-Shelby Cnty Arpt Auth, Tennessee		
Memphis Intl Arpt, Tennessee		
Memphis-Shelby Cnty Arpt Auth (Memphis Intl Arpt)		
Long Term Rating	A-/Stable	Affirmed
Memphis-Shelby Cnty Arpt Auth (Memphis Intl Arpt) arpt rev bnds dtd 07/01/2001 ser 2001A due 03/01/2003-2018 2021 ser 2001B due 03/01/2026		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings has affirmed its 'A-' long-term rating and underlying rating (SPUR) on Memphis-Shelby County Airport Authority (MSCAA, or the authority), Tenn.'s existing revenue and refunding bonds issued on behalf of Memphis International Airport (MEM, or the airport). The outlook is stable.

MSCAA owns and operates MEM as well as the Charles W. Baker and the General DeWitt Spain airports, both general aviation reliever sites. Because the financial operations of the two general aviation reliever airports are not significant to the authority, our rating is based primarily on our view of MEM's financial operations.

The ratings reflect our view of the airport's:

- Important role as the principal hub for Federal Express Corp.'s package delivery operations and rank as the U.S.' busiest cargo airport;
- Good revenue diversity in fiscal 2016, with passenger airline revenue at 25%, cargo airline revenue at 40%, and non-aeronautical revenue at 35% of total operating revenue; and
- Diverse service area economy that covers five counties across Tennessee, Arkansas, and Mississippi.

We believe those strengths are offset by the airport's material future borrowing plans that will keep debt metrics such as debt per enplanement and cost structure relatively high compared to similarly rated peers.

Net revenues from the airports' operations secure the bonds. As of June 30, 2016, MSCAA had approximately $280 million in airport revenue bonds outstanding, all of which are fixed rate. The authority has not entered any interest-rate swap agreements. It also has approximately $1.5 million in special facilities revenue bonds. MEM's debt burden is approximately $162 per enplaned passenger based on fiscal 2016 enplanements, higher than the median for a medium hub and other 'A' rated airports. We believe the airport's debt burden is currently manageable, given limited additional debt needs and a debt service schedule that has significant declines through 2026 due to amortization of existing debt. The authority's five-year capital improvement plan (CIP) is approximately $440 million, of which $199 million is to be

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financed with future bonds and $134 million with federal grants. The declining debt service schedule of current outstanding debt provides flexibility to take on future debt issuance but the CIP is sizable for the airport and the debt per enplanement is expected to remain high.

MEM historically served as a dual hub for Delta's passenger operations and for FedEx's cargo operations, but Delta has enacted service cuts that have moved the airport to an all origin and destination (O&D) airport with no connecting traffic. In fiscal 2016, enplanements were 2.0 million with O&D enplanements at 99%. The airport has become less concentrated in Delta due to flight reductions. Delta accounted for 34% of enplanements in fiscal 2016, followed by American Airlines (29%), Southwest (17%), and United Airlines (11%), with all other airlines making up the balance. As Delta reduced service, other airlines have increased their presence at MEM, expanding the airport's services and markets, resulting in increased competition and lower air fares. O&D enplanements grew from 1.68 million in fiscal 2013 to 1.95 million in fiscal 2016. Although overall enplanements have declined significantly in recent years, the O&D base is showing growth, up 4.35% in fiscal 2014, 0.8% in fiscal 2015, and 11.2% in fiscal 2016. As of to-date fiscal 2016, first-quarter O&D enplanements in 2017 are up 4% over the prior year's first-quarter activity level.

Management prepared a financial forecast, accounting for the all-O&D nature of the airport, which shows cost per enplanement (CPE) expected to peak in 2016 at approximately $13 per enplanement and then decrease in 2017 to approximately $10; meanwhile, debt service is also forecast to decline from $50 million in 2015 to $37 million in 2017. The anticipated decrease in debt service gives the authority more financial flexibility but will likely be absorbed by its future borrowing plans.

FedEx, an all-cargo air carrier, is headquartered in Memphis and operates its World Super Hub on 945 acres at MEM. FedEx operates at the airport under a 30-year lease that expires Dec. 31, 2036. The lease also contains terms providing for two 10-year extensions. FedEx has approximately 1,275 departures weekly from the airport. During fiscal 2016, the airport handled approximately 4.9 million tons of cargo. FedEx has made significant investments in its facilities at the airport. MEM was the world's second-busiest cargo airport in 2016, and has held the No. 1 cargo ranking in 20 of the past 23 years, according to Airports Council International statistics.

We believe MEM's operating revenues are somewhat diverse. For fiscal 2016, passenger airline revenues accounted for 25% of total operating revenues, cargo airline revenues 40%, and nonairline revenues 35%. MEM operates as a residual airport, which results in generally slim financial margins but keeps its cost structure low. For fiscal 2016, MEM's CPE was $11.37.

The airport's operating revenues were $104.8 million in fiscal 2016, an increase of 4.3% in from fiscal 2015. Operating expenses increased 4% to $56.3 million, which resulted in indenture coverage of 1.60x. In fiscal 2016, S&P Global Ratings-calculated coverage was weak at 1.03. The difference in the cash-flow coverage as calculated by S&P Global Ratings and the indenture coverage is that the indenture allows the use of previous-year surpluses and carryover coverage funds. Historically, coverage (as calculated by S&P Global Ratings) for MEM has been weak, ranging from about 0.93x to 1.14x, based on airport revenue bonds and general obligation (GO) bonds from fiscal years 2005 to 2016. The low coverage levels are not unusual, given the residual use and lease agreement at the airport. The authority has, in effect, individual lease agreements with each of the following air carriers serving the Memphis International Airport: American Airlines, Delta, FedEx, Southwest Airlines, United Parcel Service (UPS), and US Airways (the signatory airlines). Current agreements extend to June 30, 2017.

The authority has historically maintained a relatively weak liquidity position, in our view, as shown by its residual airline use and lease agreement, but has been built up to higher levels in recent years. MSCAA's fiscal year-end 2016 balances of current unrestricted cash and investments were about $45.5 million, or 295 days' unrestricted cash on hand.

Under the residual cost formula in the airline agreements, revenues from sources other than the signatory airline rentals and fees are credited against the airport's total operating, maintenance, and capital outlay requirements to determine the amount of the signatory airline rentals and fees. The accumulated surplus (or deficit) in the revenue fund, after all other requirements have been met, is normally a deduction (or addition) in the calculation of the net requirement to be met from the signatory airline rentals and fees.

Outlook

The stable outlook reflects our expectation that during the next two years, MEM's air cargo operations will remain strong and O&D enplanement levels will remain stable.

Upside scenario

We do not expect to raise the rating during the two-year outlook period since we believe that operational and financial metrics will remain consistent with the current rating and debt per enplanement levels will remain high.

Downside scenario

We could lower the rating if O&D traffic falls significantly below management projections, which would weaken the airport's financial risk profile. A significant increase in debt beyond current proposals could lead to a lower rating.