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Ratings

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Research Update:

Metropolitan de Tenerife 'A/A-1' Ratings Affirmed; Outlook Negative

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Overview

- We consider Metropolitano de Tenerife S.A. (MTSA) to be a government-related entity of the Cabildo de Tenerife.
- We think that there is an almost certain likelihood that MTSA would receive extraordinary government support from the Cabildo de Tenerife, if needed, given the company's critical role and integral link with its government owner.
- We do not believe the cabildo's creditworthiness could be above Spain's; nor do we think that MTSA's creditworthiness could be stronger than that of the cabildo, from which it receives ongoing support.
- We have therefore affirmed our long and short-term issuer credit ratings on MTSA at 'A/A-1' and maintained the negative outlook in line with that on Spain.

Rating Action

On Oct. 22, 2021, S&P Global ratings affirmed its 'A/A-1' long- and short-term issuer credit ratings on Spain's Metropolitano de Tenerife S.A. (MTSA). The outlook is negative, mirroring that on Spain.

Rationale

We consider MTSA to be a government-related entity (GRE) of the Cabildo de Tenerife, a local government in the Autonomous Community of the Canary Islands (A/Negative/--). MTSA is a public transport company that operates the tramlines in the metropolitan areas of Tenerife, and it is fully owned by its local government.

In our opinion, local governments in Spain generally cannot be rated above the sovereign, and in this case, we believe MTSA could not be rated higher than the creditworthiness of its related government, from which it receives ongoing support. Consequently, we cap our ratings on MTSA at the same level as the rating on Spain.

In our opinion, the cabildo would almost certainly provide timely and sufficient extraordinary support to MTSA in the event of financial distress. We base this rating approach on our view of MTSA's:

- Critical role for the cabildo. MTSA provides public transport services in the metropolitan area of Tenerife and is instrumental to the local government's policy of fostering its use. Public transport is one of the core responsibilities of the cabildo. In our view, the essential and subsidized nature of MTSA's activities make it highly unlikely that a private entity could undertake its responsibilities.
- Integral link with the cabildo. The local government fully owns MTSA and supervises and monitors its strategy and operations regularly. The company executes its investments in close coordination with the cabildo and operates under an agreement set by both MTSA and the cabildo in 2003. This stipulates that the cabildo is responsible for safeguarding the economic and financial balance of MTSA.

As a result of our view of an almost certain likelihood of support, we believe MTSA's credit quality is equivalent to that of its related government, the Cabildo de Tenerife, which in turn is limited by Spain'. In addition, we continue to assess MTSA's stand-alone credit profile (SACP) above the long-term rating, at 'a+'. This reflects our view of MTSA's very strong enterprise risk profile and strong financial risk profile.

Our assessment of MTSA's enterprise risk profile considers its service area economic fundamentals, which we view as adequate, its very strong market position, and its extremely strong management and governance. Our assessment also considers industry risk, which we view as low relative to that of other industries and sectors.

MTSA is part of an integrated transport system that also includes bus operator TITSA, which is also owned by the Cabildo of Tenerife. We understand that the relationship between the MTSA and TITSA is based on coordination to achieve an integrated mobility offering, rather than competition. Fares are set by the cabildo, which compensates MTSA for any potential reductions in fares following policy decisions or owing to social priorities.

In our view, MTSA offers an essential service in its catchment area, by linking the two largest cities on the island of Tenerife, helping to relieve pressure on the metro areas' congested roads. In our view, MTSA's market position is very strong.

However, we believe that the economic fundamentals of MTSA's catchment area are weaker than those of other Spanish peers. We believe that economic indicators on the Island of Tenerife are very much in line with the regional level, given that 40% of the Canary Islands' population lives on the island of Tenerife. The province of Santa Cruz de Tenerife has higher unemployment than Spain, at 25.6% (versus 15.3% for Spain) as of June 30, 2021. GDP per capita levels of about US$19,500 are consistently below the national average (about 80% of Spain's at year-end 2019), according to the national statistics institute. This prevents us from assessing MTSA's economic fundamentals in our highest category.

MTSA's financial results in 2020 were weaker than in previous years, as a direct consequence of COVID-19, in line with other European transport operators. Fare revenue in 2020 declined by about 34%, due to restrictions on mobility. Despite this impact, the entity received support from the cabildo. MTSA received the full amount stipulated in its contract with the cabildo as availability payment, but also received extraordinary transfers of about €2.5 million. This amount was sized to allow the company to close the year with a zero profit, down from about €5 million in profits for 2019.

Ridership in 2021 is recovering strongly versus the previous year, as the economy emerges from the pandemic and mobility approaches normal patterns. In particular, the reopening of in-person classes at the university has given a boost to MTSA's demand, since students represent about 35% of total ridership. Despite MTSA operating on the Island of Tenerife, its exposure to tourism is very limited, with tourist demand only representing about 0.5% of total ridership. We expect traffic to recover gradually, and to reach pre-pandemic levels by 2023.

We view MTSA's management and governance as extremely strong, based on our observation of solid standards of operating performance and healthy EBITDA in recent years. We view the company's financial planning as prudent, supported by continuous updates to the entity's long-term business projections, which in our view include prudent assumptions.

Although the effects of anti-COVID-19 measures led to a temporary worsening of MTSA's financial metrics, we continue to view its financial risk profile as strong. We base our assessment on the company's strong financial performance, debt and liabilities profile, and liquidity.

MTSA's financial metrics will be affected by the entity's successful refinancing of all its debt through the issuance of a €130 million sustainable bond in the summer of 2021, which now constitutes the company's only outstanding debt.

We understand the refinancing of MTSA's debt will generate a one-off loss in 2021 due to the recognition of the negative mark-to-market value of the derivatives the entity held under the previous funding structure. However, this loss has already been factored in when determining the size of the bond placement and is therefore fully financed. Despite the immediate loss, this bond has enabled MTSA to substantially reduce its interest expenditure (from about €4 million-€5 million per year to about €1.6 million). The bond has a 15-year maturity (2036), but we understand the entity intends to gradually build a sinking fund to meet debt repayment due dates.

EBITDA debt service coverage ratios declined in 2020 to about 1.0x, from 1.3x in 2019; however, we view this as a temporary effect. As fare revenue improves and the immediate impact of the derivative loss abates, we expect MTSA's debt service coverage ratios to improve to greater than 1.25x in 2022 and thereafter. Of note, because of the company's new debt structure, which is composed of nonamortizing debt, we view coverage to be somewhat overstated versus that of peers with fully amortizing debt structures. However, inclusion of assumed principal payments does not result in a change in our assessment at this time.

MTSA's average ratio of debt to net revenue for the 2018-2020 period also appears artificially high, at about 13x, due to the outsized impact of COVID-19 measures on 2020 net revenue. We consider that the entity has no need for additional debt, because its infrastructure is fully built, and capital programs are mostly related to maintenance of the infrastructure and rolling stock. We understand any further network extensions could potentially be financed by accessing EU funds or be funded by the cabildo. As a result, we believe that debt to net revenue will remain below 15x in the next two years.

Liquidity

MTSA's short-term rating is 'A-1'. We believe MTSA has a strong liquidity position. Free cash represents consistently above 100 days of operating expenditure. The company cashes in its fare revenue daily, while the local government settles the subsidized part of the tariff monthly, and the availability payment twice a year. However, the cabildo pays 60% of these two payment schemes during the first quarter of the year to prevent liquidity tensions. In 2020, MTSA had credit lines worth €2 million, which it could use in case of any delays in the transfers from the cabildo. We understand these lines were not renewed for 2021, because the entity's liquidity situation did not require it.

MTSA's liquidity is also set to receive a boost from its refinancing transaction. The refinancing allowed MTSA to free up liquidity held in its debt service reserve account, which on average represented over 55% of total available cash in recent years. We understand this cash is now fully available to MTSA, which we see leading to an improvement in its liquidity metrics that are stronger than the 2018-2020 average unrestricted days cash on hand of about 189 days and available liquidity to debt of about 5x.

We consider MTSA to have satisfactory access to external liquidity. The company proved its ability to place a sustainable bond in the markets with ample demand and a very diversified order book (both geographically and in terms of investor type). Although we do not expect MTSA to require additional funding, we expect the entity would have no difficulties tapping bank funding, if needed.

Outlook

The negative outlook on MTSA reflects that on Spain. In our opinion, local and regional governments and their GREs can be rated above the sovereign only in exceptional circumstances.

Downside scenario

We could lower our rating on MTSA in the next 12 months if we took the same action on Spain. We could also downgrade MTSA if we thought the cabildo's creditworthiness had deteriorated significantly or if the company's link with, or role for, its local government had weakened.

Upside scenario

We could revise our outlook on MTSA to stable if we took the same action on Spain.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | General: Global Not-For-Profit Transportation Infrastructure Enterprises: Methodologies And Assumptions, Nov. 2, 2020
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Research Update: Metropolitano de Tenerife, S.A. Ratings Affirmed At 'A/A-1'; Outlook Negative, Oct. 21, 2020
- Research Update: Outlook On Metropolitano de Tenerife Revised To Negative After Similar Action On Spain; 'A/A-1' Ratings Affirmed, Sept. 25, 2020

Ratings List

Ratings Affirmed	
Metropolitano de Tenerife, S.A.	
Issuer Credit Rating	A/Negative/A-1
Senior Unsecured	A