Research Update:

Metropolitan de Tenerife, S.A. Ratings Affirmed At 'A/A-1'; 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 are therefore affirming our long and short-term issuer credit ratings on MTSA at 'A/A-1'.
- The outlook is negative, reflecting that on Spain.

Rating Action

On Oct. 21, 2020, 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 area 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.

Despite the challenging environment in 2020, 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.

We continue to believe that MTSA operates under a low risk industry environment and in an oligopoly, only competing with bus operator TITSA, which is also owned by the Cabildo of Tenerife. 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 in Tenerife. The region has higher levels of unemployment than Spain, at 21.6% versus 16.2% in second-quarter 2020, and GDP per capita levels are consistently below the national average (80% of Spain's at year-end 2019), according to the national statistics institute. This prevents us from scoring MTSA's economic fundamentals in our highest category.

We expect MTSA to post weaker financial results in 2020 as a direct consequence of COVID-19, in line with other European transport operators. However, we believe the effect on MTSA will be partially mitigated by ongoing support from the Cabildo de Tenerife. The local government will provide MTSA the full amount initially budgeted via the availability payment and technical tariff by year-end 2020. Although the technical tariff will be lower due to the decrease in demand, the cabildo will pay MTSA the difference. The company will receive €5 million from the availability payment and €8 million from tariff settlements in 2020, as initially planned.

We continue to see MTSA's management and governance as effective, 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 MTSA's June 2020 revision to its annual budget with more realistic figures, given the environment.

Ridership is expected to decline by 35% on average during 2020 as a consequence of the lockdown and social-distancing measures. Despite MTSA being located in the Island of Tenerife, its exposure to tourism is very limited, with tourist demand only representing 0.5% of total trips. This explains why traffic has been recovering in recent months as restrictions have eased and schools and universities have re-opened--students represent 35% of trips. Although demand will recover gradually, we don't expect ridership to return to pre-pandemic levels until 2023. Therefore, we now see MTSA's market position as strong instead of very strong.

Although the effects of COVID-19 will lead to a temporary worsening of MTSA's financial metrics, we continue to view its financial profile as strong. We base our assessment on the company's strong flexibility, good liquidity, and adequate debt service coverage. MTSA also provides transparent reporting and detailed multiannual projections. However, its financial profile is constrained by its high debt burden.

The drop in passenger demand translates into lower EBITDA, which we estimate will decline 40% on 2019 levels. At the same time, lower fare box revenue will weaken MTSA's ability to service debt through EBITDA, which is why we now view its debt service coverage as adequate instead of strong in our previous review.

MTSA' debt remains high in an international context, although it is improving as the company gradually makes repayments according to its amortization schedule. Debt declined to €104 million in 2019 from a peak €149 million in 2013. We estimate that actual debt will be 4.3x total revenue in 2020, from 3.7x in 2019, as a consequence of lower revenue due to COVID-19.

Discussions on expanding Line 1 of the tramline were ongoing until the pandemic and have now been halted until there is a clearer and more stable environment. We are yet to have visibility on whether MTSA will finance this investment or the Cabildo de Tenerife will take the debt and then transfer the funds to MTSA. Therefore, we have not contemplated this scenario in our forecasts.

Liquidity

We believe MTSA has a good 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 on a monthly basis, and the availability payment twice a year. However it anticipates 60% of these two payment schemes during the first quarter of the year to prevent liquidity tensions. MTSA's liquidity is also supported by its contracted lines, which were €2 million at September 2020, although the entity has not used them so far.

We understand that MTSA's cash position could improve in the coming year if it cancels its syndicated loan, which currently holds 45% of total cash. Our liquidity assessment also factors in our estimate that cash to debt service will remain below 2.0x through 2022.

We consider MTSA to have satisfactory access to external liquidity. The company has access to the European Investment Bank and domestic bank loans and might consider future market funding.

Outlook

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

Downside scenario

We could lower our ratings on MTSA in the next 24 months if we took same action on Spain. We could also downgrade MTSA if we thought the owner'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: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Governments | General: Mass Transit Enterprise Ratings: Methodology And Assumptions, Dec. 18, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Outlook On Metropolitano de Tenerife Revised To Negative After Similar Action On Spain; 'A/A-1' Ratings Affirmed, Sept. 25, 2020
- Spain Outlook Revised To Negative From Stable On Mounting Fiscal and Structural Challenges; Affirmed At 'A/A-1', Sept. 18, 2020
- Spain's Autonomous Community of Canary Islands Outlook Revised To Negative; 'A' Rating Affirmed, May 29, 2020
- Spain's Metropolitano de Tenerife, S.A. Assigned 'A/A-1' Ratings; Outlook Stable, Nov. 4, 2019

Ratings List

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