Research Update:

Spain's Metropolitano de Tenerife, S.A. Assigned 'A/A-1' Ratings; Outlook Stable

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Overview

- We consider Metropolitano de Tenerife, S.A. (MTSA) to be a government-related entity of the Cabildo de Tenerife (local government).
- We think that there is an almost certain likelihood that MTSA would receive extraordinary government support from Cabildo de Tenerife, if needed, given the company's critical role and integral link with its government owner.
- We are assigning our 'A/A-1' long- and short-term issuer credits ratings to MTSA.
- The outlook is stable.

Rating Action

On Nov. 4, 2019, S&P Global Ratings assigned its 'A/A-1' long- and short-term ratings to Spain's Metropolitano de Tenerife, S.A. (MTSA). The outlook is stable.

Rationale

MTSA is a public transport company that operates the tramlines in the metropolitan area of Tenerife, which is located in the Autonomous Community of the Canary Islands (A/Stable/--). MTSA is fully owned by the Cabildo de Tenerife, the local government of the island of Tenerife.

We consider MTSA to be a government-related entity (GRE). In our opinion there is an almost certain likelihood that Cabildo de Tenerife would provide timely and sufficient extraordinary government support to the company in the event of financial distress. We base our rating approach on our view of MTSA's critical role for and integral link with its government owner.

We believe that MTSA plays a critical role for the local government as a provider of public transport services in the metropolitan area of Tenerife. Public transportation is one of the core responsibilities of Cabildo de Tenerife. MTSA is instrumental to achieving the local government's policy of fostering the use of public transport. In our view, the essential and subsidized nature of MTSA's activities make it highly unlikely that a private entity could undertake its responsibilities.

We assess the link between the local government and MTSA as integral. Cabildo de Tenerife fully owns the public transportation company, and supervises and monitors its strategy and operations regularly. We think that the chances of privatization or partial privatization of the public transport company are negligible over the coming years. The company executes its investments in close coordination with the local government.

We think that Cabildo de Tenerife has low contingent liabilities, which therefore do not constrain its capacity and willingness to support the company in a timely manner if needed. We do not doubt the owner's general propensity to support its GREs, including MTSA.

In 2003, the local government mandated MTSA to build, maintain, and operate the tramlines in the metropolitan area formed by the cities of Santa Cruz de Tenerife (the capital) and La Laguna. To do so, the Cabildo and the company signed a "management agreement" that governs the relationship between both entities, and which obliges the local government to safeguard the economic and financial balance of the company.

The management agreement includes some features that are important, in our view. First, it sets the technical tariff that MTSA receives for each passenger. This technical tariff is updated annually according to the consumer price index. Cabildo retains the fare-setting authority, and commits to pay to the company any difference between the technical tariff and the final fare paid by the user. This system ensures a stable revenue stream for MTSA.

Second, the management agreement defines the availability payment that the company receives from Cabildo de Tenerife. This payment is subject to the accomplishment of key performance indicators that are audited externally.

We assess the stand-alone credit profile (SACP) for MTSA at 'a+', which reflects our view of the company's very strong enterprise risk profile and strong financial risk profile.

The very low risk associated with the global mass transit industry underpins the company's very strong enterprise profile. Operating revenues in the sector generally show low volatility, as susceptibility to economic cycles is very limited. At the same time, barriers to entry in the sector are high and competition usually poses low risk.

We believe that MTSA operates in an oligopoly together with bus company Transportes Interurbanos de Tenerife (TITSA), which is also wholly owned by the local government.

MTSA benefits from sound economic fundamentals in its catchment area that has about 360,000 inhabitants. We observe that population growth in the area is positive and, more importantly, employment (measured as affiliates to the social security system) has soared over the past five years. However, we note that regional GDP per capita is well below the national average, while the unemployment and risk of poverty rates are much higher.

Economic fundamentals have translated into significant ridership increases in recent years (2.2% in 2017 and 7% in 2018). The company expects ridership to reach 15.2 million journeys in 2019 compared with 14.8 million in 2018. It also forecasts that ridership will continue to increase, but at a slower pace of 1% per year. We deem this figure conservative and believe that the company has enough vehicle fleet capacity to absorb more than the projected increase. Also, we see the potential to increase ridership in the future if the existing tramlines are extended, given that only 15% of motorized journeys are made on public transport.

We regard MTSA's management and governance as effective, based on our observation of solid standards for operating performance and healthy EBITDA generations. We view the company's financial planning as prudent and realistic in general, and the management team as transparent and experienced. Furthermore, we note that the company is innovative. This is illustrated by its in-house developed safety system (SIMOVE) and its smartphone payment system (ten+movil), which only needs to capture a Quick Response (QR) code and does not require a machine to validate the ticket. We will monitor developments in the company's strategy and, in particular, any new large investment project mandated by its owner.

We assess the company's financial risk profile as strong. In our view, the profile is constrained by high debt, while we deem debt service coverage and financial flexibility as very robust. In our view, financial policies are strong when compared internationally.

The company entered into debt to fund the construction of the two tramlines it operates. Debt levels are declining but remain very high, in our view. We expect total debt to reach €97 million, or 7.9x EBITDA by year-end 2021.

We understand that debt could increase in the future if the local government decided to extend the tramlines and fund this expansion with debt at the company level. Alternatively, the local government may decide to fund the works directly and transfer the funds to the company to build the new lines. However, this is yet to be decided.

We observe that the company's debt service capacity is very robust, with a debt-service-coverage ratio of about 1.3x. This is because the company posts solid EBITDA, which includes the renovation and overhaul program as operating expenditure. EBITDA margins hover at about 40% of operating revenue.

In our view, the company will maintain a high degree of financial flexibility over the next few years. The company's fare box recovery ratio, excluding subsidies on the technical tariff paid by the local government, covers more than 80% of operating revenue, which is higher than international peers'. Counterbalancing this, the debt service carrying charge is weak, representing more than 30% of debt service plus operating expenditure.

Liquidity

The short-term rating on MTSA is 'A-1' and we assess its liquidity as strong. We note that free cash represents consistently more than 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 at the company level. Our liquidity assessment also factors in our estimation that cash to debt service will remain below 2x through 2021.

We consider MTSA's access to external liquidity to be satisfactory. The company has access to the European Investment Bank and domestic banks.

Outlook

The stable outlook reflects that on Spain (unsolicited A/Stable/A-1) given that, in our opinion, general local and regional governments and their GREs can only be rated above the sovereign in exceptional circumstances.

Upside scenario

We could raise the ratings on MTSA if we took the same action on Spain and estimated that Cabildo de Tenerife retained its individual credit profile, indicating its capacity to provide extraordinary financial support to MTSA if needed.

Downside scenario

Conversely, we would lower the ratings if we lowered the sovereign rating. We could also downgrade the company if we anticipated a weakening of its owner's creditworthiness or an adverse change in the company's role for and link with the local government. However, we see these scenarios as unlikely.

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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Autonomous Community of Canary Islands Upgraded To 'A' After Similar Action On Spain; Outlook Stable, Sept. 25, 2019
- Spain Ratings Raised To 'A/A-1' From 'A-/A-2' On Economic Resilience; Outlook Stable, Sept. 20, 2019

Ratings List

New Rating; Outlook Action	
Metropolitano de Tenerife, S.A.	
Issuer Credit Rating	A/Stable/A-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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