FitchRatings

25 AUG 2021

Fitch Affirms High Speed Rail Finance (1) Notes at 'A-'/Stable

Fitch Ratings - London - 25 Aug 2021: Fitch Ratings has affirmed High-Speed Rail Finance (1) PLC's senior secured notes and programme ratings at 'A-' with Stable Outlook. The issuer is the funding vehicle for HS1 Limited, which is the operator of the only high-speed railway in the UK.

A full list of ratings is below.

RATING RATIONALE

The global pandemic has caused an unprecedented impact on HS1: Eurostar has been operating without pre-booked FWT (forward timetable) since December 2020, LSER has booked a timetable that is below the government-guaranteed underpin level for the period of May 2021 to December 2021, and the unregulated business has declined significantly during financial year to March 2021. Fitch believes that the Covid-19 pandemic has increased uncertainty over train-path volumes and has weakened the sector's general operational risk profile.

However, the comprehensive contractual and regulatory arrangements and the essential infrastructure HS1 operates to some extent mitigate the risk and support stability of cashflows in the medium term. Under Fitch's rating case (FRC) HS1's debt service coverage ratio (DSCR) has reduced in the short term but is expected to remain robust over the forecast horizon, averaging at 1.6x between FY22 and concession maturity in FY40.

KEY RATING DRIVERS

Coronavirus Affecting International Traffic, Domestic Traffic Remains Strong; Volume Risk: 'Stronger'

The number of international train paths that HS1 received payment for have dropped by nearly one quarter in FY21, which is fairly resilient versus the drastic passenger volume decline for the same period. Although Eurostar has been operating on only spot bids since December 2020, it has started to pre-book a minimum FWT for the period between December 2021 and May 2022, which signals potentially increasing volumes. Fitch estimates that the negative impact on international traffic caused by Covid-19 will gradually recede before a full recovery to 2019 levels is reached by 2024.

The number of domestic train paths remained stable for FY21 due to pre-booked FWT. However, for the period from May 2021 to December 2021, HS1's domestic train paths are only at the underpin level as the volume booked by LSER has dropped below the underpin level. The UK government continues to guarantee around 95% of the pre-Covid 19 timetabled domestic train paths as part of the underpinned volume scheme, making domestic revenue effectively availability-based.

RPI Link, Costs Pass-Through; Price Risk: 'Stronger'

The concession framework allows the sponsors to recover their invested capital including debt through an RPI-linked investment recovery charge, which represented over 77% of EBITDA in FY21. Unlike most regulated assets in the UK, this is not subject to periodic regulatory review. The RPI revenue swap mitigates the risk of low inflation, as HS1 will receive cash flows at a fixed growth while the payable portion will accrete as per realised RPI.

The operations-and-maintenance recovery charge (OMRC) component of revenues is designed to meet the majority of HS1's operating, maintenance and renewal costs, and is subject to benchmarking and review every five years. The OMRC charges can also be 'reopened' before the five-year review cycle under certain circumstances, such as where traffic is +/- 4% the forecasts presented at the beginning of the control period. HS1 initiated a volume reopener in December 2020, and the new calculated OMRC started from February 2021. It is possible to reopen the OMRC calculation again by the end of this year.

Fully Outsourced to Experienced Operator; Operation Risk: 'Stronger'

The majority of O&M is outsourced to a subsidiary of Network Rail Infrastructure Finance Plc (AA-/Stable), the leading rail infrastructure operator in the UK, which guarantees the subsidiary's obligations.

The concession and operating agreements are not strictly 100% back-to-back, and in contrast to standard private finance initiative (PFI) concessions there is a limited universe of replacement operators. However, Fitch believes HS1's ability to periodically renegotiate the terms of the operating agreement mitigates these risks. HS1 also benefits from a substantial pass-through of liabilities to train-operating companies.

High Visibility on Capex; Infrastructure Development & Renewal Risk: 'Stronger'

HS1's infrastructure is well-maintained and has consistently outperformed requirements and expectations. Major maintenance services are largely the responsibility of the operator, while HS1's responsibilities are limited and predictable. Forward-looking escrow arrangements in respect of track-and-station capex provide high visibility of O&M and renewal costs. The five-year concessionaire's review of asset conditions is expected to prevent HS1 incurring unexpected handover liabilities at concession maturity.

Solid Debt Structure; Debt Structure: 'Stronger'

The rated debt is senior secured and fully amortising, with more than 95% of the current outstanding debt either at fixed or swapped interest rates. A dedicated 12-month liquidity facility within the ring-fenced group, together with covenanted lock-up and default ratios, provide strong creditor protection. The amortisation of legacy swaps' crystallised mark-to-market value is fixed and reflected in the DSCR metric.

Financial Profile

Under FRC, HS1's DSCR profile is robust, averaging 1.6x from FY22 until concession maturity, with a minimum DSCR of 1.12x in FY22, a breach of the lock-up covenant. Despite the short-term deterioration, the average DSCR in the FRC of 1.6x remains above our negative sensitivity trigger. We run a severe stress case where international train paths are down to zero, domestic train paths revert to government-underpinned volumes only, and unregulated revenue is down by half until the concession ends in 2040. Even under this stress case the average DSCR remains at around 1.0x.

PEER GROUP

Channel Link Enterprises Finance Plc (CLEF; rail/transportation, BBB/Stable) has the same catchment area as HS1's international traffic. CLEF benefits from materially lower leverage compared with HS1 but weaker DSCR metrics and a 'Midrange' debt structure. We view HS1 as stronger than CLEF in terms of lower expected volatility in revenue, as well as lower operating costs and infrastructure renewal costs, which explains the two-notch difference in their ratings.

Given the stable revenue profile and metrics, HS1 compares well with Meridian Hospital Company PLC (hospital PFI concession), whose bond is rated 'BBB+'/Stable with an average DSCR of 1.5x. Meridian benefits from 100% availability-based revenues, but HS1 has a higher DSCR of 1.6x and an operating profile that is not substantially higher risk, in our view.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Material underperformance of FRC, resulting in an average DSCR of below 1.45x from FY22 until debt maturity.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade is unlikely as we believe that HS1 could raise additional debt.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

TRANSACTION SUMMARY

The high-speed rail line connects London's St Pancras International station to high-speed commuter services throughout Kent, and international passenger destinations in Europe, mainly Paris and Brussels, via the Channel Tunnel.

CREDIT UPDATE

Performance

HS1's FY21 revenue decreased 19% to GBP191.8 million, weighed down mainly by significantly reduced revenue from the unregulated business (ie: retail, car parks, -58% vs. FY20) throughout the financial year and reduced revenue from Eurostar when it switched to fully spot bid in 4QFY21. EBITDA dropped 42% to GBP55.1 million with a weaker margin of 29% (40% in FY20), driven by higher proportionate costs relative to fewer train paths. The contractual framework to some extent protected HS1's FY21 results, as it has invoiced a total of 69,868 paths due to FWT, while only 48,331 paths were actually operated on.

Liquidity Remains Sufficient but Cash Balance Reduced

As of end-July 2021, HS1 had GBP3 million cash in hand, as well as a committed undrawn liquidity facility (LF) and working-capital facility (WCF) of GBP125 million and GBP51 million, respectively. The company's remaining debt service for 2021 is GBP44.6 million, and debt service for 2022 is GBP107.3 million.

The low cash balance is deemed short-term, reflecting Covid-19 impacted revenue as well as the delayed timing to received payment due to the spot bid mechanism versus FWT. However, HS1 plans to use self-generated cash for debt repayment, as it is expecting to receive two sets of GBP68 million domestic track-access income in September and December, sufficient to cover the remaining debt service and to repay part of the WCF, which is a revolving facility maturing in 2024, with a possibility of further extension.

Additionally, monthly income from Eurostar and the unregulated business amounts to GBP2 million-GBP3 million.

HS1 does not plan to repay debt with LF, which is fully undrawn. WCF was extended during FY21 to GBP84 million from GBP65 million.

Train Volumes Improving but Uncertainties Remain due to Covid-19

The roll-out of vaccination, the gradually relaxed regulation on cross-border travel, and the increasing number of commuters are contributing to the return of rail passengers on Eurostar and LSER. However, the potential spread of new virus variants or another wave of existing virus, as well as its containment measures might again weigh on train operators.

Eurostar has been operating without FWT since December 2020. For several months, Eurostar had operated only two return services daily before starting to ramp up its operations in May 2021. It has confirmed an increase to eight daily return services between 6 September and 1 November 2021, and for the period between December 2021 and May 2022, Eurostar has pre-booked FWT of 2,200 train paths.

LSER currently operates below the underpin level for the period between May 2021 and December 2021, while Department for Transport (DfT) tops up the gap to reach the underpin level. LSER won the franchise through the government's direct awards in March 2020 and continues to operate under the emergency measurement agreement (EMA), which allows the government to take over all revenue and cost risks. This scheme is expected to end in October 2021, with a possibility to extend by six months to March 2022. Afterwards, it is expected to move to national rail contract (NRC), which is similar to EMA in terms of stable revenue and costs. Eventually, all rail transport contracts and/or schemes will be transitioned to Great Britain Railway (GBR, a government body that oversees rail transport for Great Britain from 2023). Compared with direct awards and NRC, the GBR scheme creates the potential for more upside growth on domestic train paths.

OMRC Reopener

The regulatory framework indicates that HS1 cannot over- or under- recover their OMRC costs, therefore, once the changes in train numbers exceed certain thresholds (+/- 4% for passenger services, +/- 12.5% for freight services), volume reopener provisions will be initiated to re-apportion costs between train operators to ensure HS1 can appropriately recover its OMRC costs.

During FY21 the total train paths operated on HS1 have decreased more than 4%. Hence, HS1 initiated the volume reopener process in December 2020, and ORR (Office of Rail and Road) has approved the reallocation of OMRC costs based on the newly forecast train paths for both international and domestic train operators in February 2021.

According to the company, there is a possibility to initiate another volume reopener process by the end of this year given the uncertainties brought about by Covid-19.

Fitch Cases

This year FRC continues to reflect our conservative assumptions relative to the management case for the coronavirus impact on both international and domestic train-path growth. Under FRC for international traffic, we expect traffic in FY22 to reduce 65% from FY19. Considering Eurostar's actual train-path movement in FY21 (-24%), and management's expectation for FY22 versus FY19 (-35%), Fitch's assumption is deemed conservative, but largely in line with our EMEA airport volume recovery for FY22. We expect international traffic volume to gradually recover to FY19 levels in FY24. For domestic traffic, we conservatively assume the underpin level to continue until 2023, when LSER's operation change from EMA to GBR, which will then bring higher upside growth.

We forecast the average DSCR profile between FY22 and FY40 at 1.6x with a minimum DSCR of 1.12x, breaching the lock-up covenant for one year in FY22 before swiftly recovering to above lock-up level. This is deemed robust under our rating assumptions.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Fitch Ratings Analysts

Tingting Liuyang
Senior Analyst
Primary Rating Analyst
+44 20 3530 2729
Fitch Ratings Ltd 30 North Colonnade, Canary Wharf London E14 5GN

Radim Radkovsky
Director
Secondary Rating Analyst
+44 20 3530 1254

Shyamali Rajivan
Director
Committee Chairperson
+44 20 3530 1733

Media Contacts

Athos Larkou
London
+44 20 3530 1549
athos.larkou@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR
High Speed Rail Finance (1) PLC			

ENTITY/DEBT	RATING		RECOVERY	PRIOR
• HS1 Limited/Debt/1 LT	A-	Affirmed		A-

RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Infrastructure and Project Finance Rating Criteria -- Effective March 24, 2020 to Aug. 23, 2021 (pub.24 Mar 2020) (including rating assumption sensitivity)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Third-party Model, v (23 August 2021)

Additional Disclosures

Solicitation Status

Endorsement Status

High Speed Rail Finance (1) PLC	UK Issued, EU Endorsed

Disclaimer

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, THE FOLLOWING HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE

Copyright

Endorsement policy

Fitch’s international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch’s approach to endorsement in the EU and the UK can be found on Fitch’s Regulatory Affairs page on Fitch’s website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.