FitchRatings

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

Fitch Ratings - London - 31 Jul 2023: Fitch Ratings has affirmed High Speed Rail Finance (1) PLC's senior secured notes and programme ratings at 'A-' with a Stable Outlook. The issuer is the funding vehicle for HS1 Limited, which is the concessionaire of the only high-speed railway in the UK.

RATING RATIONALE

HS1 continues to benefit from the robust operating profile and its critical nature as the high-speed railway connection between the UK and continental Europe. Domestic volumes remain substantially underpinned by the UK government, which mitigates volume risk and supports cash-flow stability. We view the demand for international traffic as robust in the long term, supported by the strong recovery in the financial year ending 31 March 2023 (FY23). We currently assume demand to substantially recovery by FY28 from the pandemic shock.

Tariffs are based on RPI-linked investment recovery charges and a pass-through of operating costs. HS1 outsources most operations and maintenance (O&M) tasks to an experienced operator. Debt is fully amortising and secured, with minimal exposure to interest-rate risk.

Combined with a robust debt service coverage ratio (DSCR) profile averaging 1.6x under the updated Fitch Rating Case (FRC), this leads to HS1's 'A-' rating and Stable Outlook.

KEY RATING DRIVERS

Domestic Underpin, International Recovering; Volume Risk: 'Stronger'

The UK government guarantees around 95% of pre-pandemic domestic train paths as part of the underpinned volume scheme, making domestic revenue effectively availability-based. International volumes are based on dominant Eurostar train services from London to the continent.

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

The concession framework allows HS1 sponsors to recover their invested capital including debt through an RPI-linked investment recovery charge, which represented around 76% of EBITDA in FY23. 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, maintenance and renewal costs (OMRC) component of revenues is designed to meet the majority of HS1's OMRC, and is subject to benchmarking and review every five years. The OMRC 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. Since the pandemic, HS1 has initiated three 'volume reopeners', and has successfully reproportioned the costs based on lower train paths both domestically and internationally.

High Capex Visibility, Well-Maintained Aging Assets; Infrastructure Development & Renewal Risk: 'Stronger'

HS1's assets have continuously outperformed operational expectations and are generally well maintained but gradually ageing. Major maintenance services are largely the responsibility of the operator, while HS1's responsibilities are limited and predictable. Forward-looking escrow arrangements for track and station capex provide high visibility of 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.

As of June 2023, HS1 had a GBP160 million liquidity facility and GBP84 million revolving credit facility, both undrawn.

Financial Profile

Under FRC, HS1's DSCR profile remains robust, averaging 1.6x between FY23 and FY40, with a minimum DSCR of 1.35x in FY25. Despite the short-term deterioration, HS1's long-term credit metrics remain well above our negative sensitivity trigger of 1.4x.

PEER GROUP

Channel Link Enterprises Finance Plc (CLEF; rail/transportation, BBB/Stable) has the same catchment area as HS1's international traffic. CLEF's volume is assessed as High Midrange, weaker than HS1, driven by higher demand volatility. CLEF has a lower DSCR than HS1 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 private finance initiative concession), whose bond is rated 'A-'/ Stable with an average DSCR of 1.5x and a minimum DSCR of 1.3x. Meridian benefits from 100% availability-based revenues, which underpin the 'A-' rating, despite having a lower DSCR than HS1's 1.6x.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

Material underperformance of the FRC, resulting in an average DSCR well below 1.4x

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade is currently 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, Brussels and Amsterdam, via the Channel Tunnel.

CREDIT UPDATE

The total annual train paths billed in FY23 increased 15% yoy to 67,877, mainly driven by recovering international traffic, while domestic contributes to up to the underpin level.

The billed international train paths in FY23 (including both pre-booked and spot bid) increased 162% yoy to 14,509, of which pre-booked paths accounted for 52%. Eurostar then submitted further increased pre-booked train paths to around 80% of the pre-pandemic level for May 2023-December 2023.

The number of pre-booked domestic train paths for May 2023-December 2023 remains below the underpin arrangement of 1,024 paths per standard week. Consequently, HS1 remains reliant on timely payments from the Secretary of State, Department for Transport, in accordance with the concession agreement, which helps to absorb cash flow depletion.

Although the current pre-booked train paths for both international and domestic traffic are around 80% of their respective pre-pandemic level, HS1's total billed train paths in FY23 were 92% of the pre-pandemic level. This not only reflect the robust contractual protections of the underpin scheme, but also captured the strong post-pandemic recovery from international route.

FINANCIAL ANALYSIS

The FRC reflects our conservative assumptions over the management case on both international and domestic train path growth, with an aggregate of about 1% CAGR from FY23 to FY40. Under the FRC, we expect total train paths to be substantially back to FY20 levels by FY28 for domestic and international paths. O&M as well as power and station charges are substantially passed on to train operating companies, meaning there is no exposure to cost overruns or margins pressures.

HS1's DSCR profile remains robust under the FRC, at an average of 1.6x. The minimum DSCR is 1.35x, reflecting Fitch's expectation of an improvement in HS1's performance. Despite a weakening in the short term, its credit metrics maintain a buffer against our negative sensitivity trigger.

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
High Speed Rail Finance (1) PLC					
• High Speed Rail Finance (1) PLC/ Debt/ 1 LT	LT	A-	Affirmed		A-

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Infrastructure & Project Finance Rating Criteria (pub.17 May 2023) (including rating assumption sensitivity)

Transportation Infrastructure Rating Criteria (pub.16 May 2022) (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 (17 May 2023)

Additional Disclosures

Solicitation Status

Endorsement Status

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

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