FitchRatings

Fitch Affirms High Speed Rail Finance (1) PLC; Stable Outlook

Fitch Ratings-London-14 September 2018: Fitch Ratings has affirmed High Speed Rail Finance (1) PLC's (HSRF-1) senior secured notes as follows:

GBP5 billion multi-currency note issuance programme: affirmed at 'A-', Outlook Stable
GBP610 million fixed-rate bonds, maturing November 2038: affirmed at 'A-', Outlook Stable
GBP268 million index-linked bonds, maturing November 2038: affirmed at 'A-', Outlook Stable

KEY RATING DRIVERS
HS-1 Limited (HS-1; the rail operator) benefits from a robust operating profile. Domestic volumes are substantially underpinned by the UK government. We view the international traffic as stable. Tariffs are based on RPI-linked investment recovery charges and a pass through of operating costs. HS-1 outsources most operations and maintenance (O&M) to an experienced operator. The debt is fully amortising and secured, with substantially no exposure to interest rate risk. Fitch's rating case debt service coverage ratio (DSCR) profile is robust, averaging 1.6x from 2020 until concession maturity.

The RPI revenue swap entered into by HS-1 in 2017 improves the DSCR profile. However, the ratings remain constrained as we believe HS-1 could raise additional debt in future.

Highly Stable Volumes. Volume Risk: Stronger
The UK government guaranteed 95% of domestic train paths in the year to March 2018, making domestic revenue effectively availability based. Domestic train paths contributed 64% of EBITDA in the 12 months to March 2018 (FY18). International volumes are based on the stable and dominant Eurostar train services from London to the continent, predominantly Paris and Brussels.

RPI link, Costs Pass-through. Price Risk: Stronger
The concession framework allows the sponsors to recover their invested capital including debt through the RPI-linked investment recovery charge, which represented 89% of EBITDA in FY18. Unlike most regulated assets in the UK, this is not subject to periodic regulatory review. The RPI revenue swap mitigates the risk of a low inflation scenario, as HS-1 will receive cash flows growing at a fixed rate while the payable leg will accrete as per realised RPI.

The operations and maintenance recovery charge (OMRC) component of revenues is designed to meet the majority of HS-1's operating, maintaining and renewal costs, and is subject to benchmarking and review every five years. The five-year review period could be reopened under certain circumstances, such as traffic being 4% above or below the forecasts presented at the beginning of the control period.

Full Outsourcing to an Experienced Operator. Operation Risk: Stronger
The majority of O&M is outsourced to a subsidiary of Network Rail Infrastructure Finance Plc (AA/Negative), 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 PFI concessions there is a limited universe of replacement operators. However, we believe HS-1's ability to periodically renegotiate the terms of the operating agreement mitigates these risks. HS-1 also benefits from a substantial pass-through of all liabilities to train-operating companies.

High Visibility on Capex. Infrastructure Development & Renewal Risk: Stronger
Major maintenance is largely the operator's responsibility, with HS-1's responsibility 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 HS-1 incurring unexpected handover liabilities at concession maturity.

Solid Debt Structure. Debt Structure: Stronger
The rated debt ranks senior and pari passu, is secured and considered fully amortising, with 97% of the current outstanding debt either at fixed or swapped interest rates. The dedicated 12-month liquidity facility within the ring-fenced group, together with the covenanted lock-up and default ratios are strong features. The amortisation of the legacy swaps' crystallised mark-to-market value is fixed and reflected in the DSCR metrics, and the additional debt service is small at GBP17 million a year until 2026.

Financial Profile
Under Fitch's rating case, the DSCR profile is robust, averaging 1.6x from 2020 until concession maturity, with a minimum DSCR of 1.5x in 2024.

PEER GROUP
Channel Link Enterprises Finance Plc (CLEF; rail/transportation, BBB/Stable) has the same catchment area as HS-1's international traffic. CLEF benefits from materially lower leverage compared with HS-1 but weaker DSCR metrics and a midrange debt structure. We consider HS-1 to be stronger than CLEF in terms of lower expected volatility in revenue, operating and infrastructure renewal costs, which explains the two-notch difference.

Given the stable revenue profile and metrics, HS-1 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 HS-1 has higher DSCR of 1.6x and an operating profile that, in our view, is not substantially riskier.

RATING SENSITIVITIES
Developments That May, Individually or Collectively, Lead to Positive Rating Action:
- An upgrade is unlikely as we believe that HS-1 could raise additional debt.

Developments That May, Individually or Collectively, Lead to Negative Rating Action:
- Material underperformance of the rating case, resulting in an average DSCR from 2020 until debt maturity of below 1.45x.

CREDIT UPDATE
Performance Update
HS-1 slightly outperformed Fitch's expectations in FY18, with an EBITDA 3% higher than Fitch's 2017 base case projections. This was mainly driven by a better-than-expected performance in the unregulated business and by a train path higher by 0.3% on our base case projections. The 8.9% fall in Eurostar paths in 2017/18 compared with control period 2 expectations, which followed the introduction of bigger trains, triggered the 4% reopener and new higher OMRC rates have been calculated and applied since April 1, 2018.

Fitch Cases
Fitch's 2018 rating case reflects more conservative assumptions than the management case for international and domestic path growth, increasing at an aggregated CAGR of 0.6% until 2040. As the average DSCR is inflated by three years of high coverage between FY18 and FY20 due to an interest-only period, we disregarded this period in the average DSCR calculations.

The average DSCR profile between 2020 and 2040 at 1.6x with a minimum 1.5x is robust, and also benefits from the RPI revenue swap contribution to the operating cash flow. Fitch notes that the replacement and collateralisation language included in the RPI swap exposes the rating to a certain degree of volatility, as the credit linkage between the rated debt and the hedging counterparties has increased. The counterparty ratings are currently at or above those of HS-1.

Asset Description
HS-1 is the operator of the only high-speed railway operating in the UK. The 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.

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Applicable Criteria
Rating Criteria for Infrastructure and Project Finance (pub. 27 Jul 2018)
(https://www.fitchratings.com/site/re/10038532)

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