FITCH REVISES HIGH SPEED RAIL FINANCE (1) PLC'S OUTLOOK TO STABLE

Fitch Ratings-London-27 September 2016: Fitch Ratings has revised the Outlook on High Speed Rail Finance (1) PLC's (HSRF-1) senior secured notes to Stable from Positive and affirmed their ratings, as follows:

GBP5bn multi-currency note issuance programme: affirmed at 'A-', Outlook revised to Stable from Positive
GBP610m fixed-rate bonds, maturing November 2038: affirmed at 'A-', Outlook revised to Stable from Positive
GBP257m index-linked bonds, maturing November 2038: affirmed at 'A-', Outlook revised to Stable from Positive

The Outlook revision reflects Fitch's latest assumptions over additional leverage. We expect the group to shortly issue new pari passu notes maturing in 2039 up to an amount of GBP314m, which will lower the coverage metrics over the concession period. Under Fitch's new rating case, the debt service coverage ratio (DSCR) profile is robust and fairly flat, averaging approximately 1.5x from 2020 until concession maturity in 2040. We perceive the fully amortising and secured debt structure, with limited exposure to interest rate risk, as strong credit features.

HS-1 Limited's (HS-1) robust operating profile, matching availability-based domestic revenues with stable international volume-based revenues, and RPI-linked investment recovery charges support the ratings. Fitch perceives as strong credit features HS-1's outsourcing of the majority of operations and maintenance (O&M) to an experienced operator and the substantial pass-through of all liabilities to train-operating companies.

TRANSACTION PERFORMANCE
HS-1 has consistently outperformed Fitch's expectations. As of end-March 2016 the EBITDA was 3% higher than Fitch's projections, despite experiencing a decline as a result of entering control period 2 compared with the prior year. Train paths billed increased 2.1% compared with the prior period, mainly driven by additional domestic services to Ashford. International traffic grew 0.8% yoy.

RATING CASE ASSUMPTIONS
The Fitch rating case reflects a temporary reduction in traffic (international train paths down 5% in 2017, reflecting Eurostar's lower passenger figures on the Paris/Brussels routes in 1H16) followed by a gradual recovery. Under the Fitch Rating case traffic is back at the 2015 historical peak in 2025.

KEY RATING DRIVERS
Highly Stable Volumes. Volume risk: Stronger
Infrastructure charges that train operating companies pay on train paths drive HS-1's revenues. The project benefits from a guarantee from the UK government, which covered 96% of domestic train paths in the financial year to March 2016, effectively making this income an availability-based cash flow. Domestic traffic represented approximately 64% of HS-1's EBITDA in FY16. International volumes are based on highly stable and dominant Eurostar train services from London to 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 (IRC), which represented 88.5% of EBITDA in FY16 and, unlike most regulated assets in the UK, is not subject to periodic regulatory review. The operations and maintenance recovery charge (OMRC) component of revenues is designed to meet the majority of HS-1's operating, maintaining and renewing costs, and is subject to benchmarking and review every five years.

Full Outsourcing to an Experienced Operator. Operation Risk: Stronger

The majority of O&M is outsourced to a subsidiary of Network Rail (AA/Negative), the leading rail infrastructure operator in the UK, which guarantees the subsidiary's obligations. While 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, we believe HS-1's ability to periodically renegotiate the terms of the operating agreement partially mitigates these risks. HS-1 also benefits from a substantial pass-through of all liabilities to train-operating companies, which will eventually face the burden of increasing costs.

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 96% of the current outstanding debt either at fixed or swapped interest rates. The proposed bullet maturity reducing the tail at the end of the concession does not weigh on the assessment of the refinance risk. The dedicated 12-month liquidity facilities at both HSRF-1 and HS-1 levels, together with the covenanted lock-up and default ratios- also support the stronger assessment.

We do not deem the presence of offsetting swaps as posing significant additional risk to the debt structure, given that the amortisation of the swaps' crystalised mark-to-market value is fixed and reflected in the DSCR metrics, and the additional debt service is small at GBP17m each year until 2026.

Financial analysis

The DSCR profile is fairly stable; however, the average DSCR is inflated by three years of high coverage between FY17 and FY20 due to an interest-only period. Therefore, in the average DSCR calculations we disregarded this period. Fitch rating case incorporates conservative assumptions on international traffic and RPI, resulting in average DSCR between 2020 and 2040 at1.5x with a minimum 1.4x.

The breakeven analysis run on international traffic confirms the debt's resilience to the risk of a sharp contraction in traffic volume. The strength of the credit is corroborated by the project's ability to fully and timely meet its senior debt service payments under the assumptions of -6% yoy declines in Eurostar train traffic. In this analysis the domestic traffic was limited to the portion underpinned by the UK government (60% of total base case traffic) and the revenues from the unregulated business were reduced by 5% from the base case.

Peers

Rail/transportation company Channel Link Enterprises Finance Plc (CLEF, BBB/Stable) shares the same catchment area as HS-1's international traffic. CLEF benefits from materially lower leverage than HS-1 and a longer 36-year tail to concession maturity, but weaker DSCR metrics.

HS-1 is stronger than CLEF in terms of lower expected volatility in revenues and operating and infrastructure renewal costs, explaining the two-notch rating difference.

Given the stable revenue profile and metrics, HS-1 compares well with hospital PFI concession Meridian Hospital Company PLC (BBB+/Positive). While Meridian benefits from 100% availability-based revenues, we believe that HS-1's operating profile is not substantially higher-risk despite the volume-based element.

RATING SENSITIVITIES
Given Fitch's current expectations regarding further indebtedness, an upgrade is unlikely.
On the contrary, sustained underperformance or external shock leading to material underperformance of the rating case, resulting in an average DSCR over the period from 2020 until debt maturity below 1.45x could trigger negative rating action.

SUMMARY OF CREDIT
HS-1 is the operator of the only high speed railway operating in the UK (High Speed 1). The rail line connects London St Pancras International station to high speed commuter services throughout Kent, and international passenger destinations in Europe such as Paris and Brussels via the Channel Tunnel.

Contact:

Primary Analyst
Giulia Noli
Associate Director
+44 20 3530 1124
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Secondary Analyst
Shyamali Rajivan
Director
+44 20 3530 1733

Committee Chairperson
Ian Dixon
Managing Director
+44 20 3530 1815

Media Relations: Francoise Alos, Paris, Tel: +33 1 44 29 91 22, Email: francoise.alos@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Rating Criteria for Infrastructure and Project Finance (pub. 08 Jul 2016)
https://www.fitchratings.com/site/re/882594