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Research Update:

High Speed Rail Finance PLC Proposed Issuance Assigned Preliminary 'A-' Rating; Outlook Stable

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Overview

- High Speed Rail Finance PLC (HSRF) has today announced its intention to issue up to £314 million of senior secured rated debt, comprising up to £184 million amortizing fixed-rate notes and up to £130 million bullet repayment fixed-rate notes.
- The debt ranks pari passu with all senior secured debt at HSRF and sister companies High Speed Rail Finance 1 PLC (HSRF1) and High Speed 1 Ltd. (HS1). HS1 is the operator of the U.K.'s high-speed rail connection between London and the Channel Tunnel.
- We are assigning preliminary 'A-' long-term issue ratings to HSRF's proposed debt, which reflects our view of the project's operations phase risk profile post the successful debt issuance.
- The stable outlook reflects our view that the project will continue to deliver strong operational performance, maintain a minimum annual debt service coverage ratio of at least 1.4x under our base case and benefit from a supportive and stable regulatory regime.

Rating Action

On Sept. 26, 2016, S&P Global Ratings assigned preliminary 'A-' long-term issue ratings to the proposed senior secured debt to be issued by U.K.-based special-purpose vehicle High Speed Rail Finance PLC. The outlook is stable. The proposed debt comprises up to £184 million amortizing fixed-rate notes and up to £130 million bullet repayment fixed-rate notes.

Rationale

Our preliminary ratings reflect our view of the project's operations phase stand-alone credit profile (SACP), which we assess at 'a-'. The project entered into operations in 2007 and hence there is no construction risk. HSRF is a sister company of High Speed Rail Finance 1 PLC (HSRF1) and High Speed 1 Ltd. (HS1). All senior secured debt issued by these entities ranks pari passu.

HS1 operates the high-speed rail line and associated infrastructure connecting London and the Channel Tunnel under a concession agreement with the U.K. government, which terminates in 2040. Operationally, the project benefits from a transparent and supportive regulatory framework that helps to mitigate operational risk and leads to a strong operational performance in terms of safety and track availability. It has a strong competitive position as the sole high-speed rail connection and the majority of its revenues (about 90%)

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come from highly stable, inflation-linked regulated track- and station-related charges, paid by the two train operators: the domestic train operator, London & South Eastern Railway Ltd. (LSER; trading as Southeastern); and the international train operator, Eurostar International Ltd. (EIL). Regulated revenues are supplemented by income from unregulated retail, car-parking, and commercial operations. We view the project's market exposure to be very low due to the protection afforded by its contractual structure.

The proposed issuance by HSRF will increase the project's total debt and weaken its credit profile, leading to weaker annual debt service coverage ratios and a more back-ended debt repayment profile. Although the decline in the minimum annual debt service coverage ratio (ADSCR) is limited under our base-case assumptions, the increased debt amount does reduce the average cover ratio. Under our base case analysis, we project the minimum ADSCR to fall to 1.44x from 1.46x and the average ADSCR to fall to 1.65x from 1.79x. In addition, the revised amortization of the debt is relatively back-ended for a project reliant on growth assumptions. The new debt issuance has shortened the concession tail to one year from two years, and includes a bullet repayment of up to £130 million in December 2039. Consequently, the financial performance of the project, which has an inflation-linked revenue stream, deteriorates under long-term, sustained low inflation rates. We reflect this weakness by assigning a one-notch negative debt structure adjustment to the preliminary operations phase stand-alone credit profile (SACP).

We have placed our existing 'A' ratings on the debt issued by HSRF1 on CreditWatch negative, reflecting the high likelihood that the additional debt will be issued, and the rating on the pari passu debt at HSRF1 will therefore be lowered to the level of the preliminary rating on HSRF. For more details, see "High Speed Rail Finance 1 PLC 'A' Issue Ratings On CreditWatch Negative Following Announced Debt Issuance," published today on RatingsDirect.

Liquidity

We assess the project's liquidity as neutral. The project maintains a 12-month liquidity facility agreement through to March 2040 equal to the forthcoming 12 months of scheduled debt service (principal and interest, including amortization and interest of the offsetting swaps). In addition, it maintains a £65 million working capital facility through to March 2020 that is more than sufficient to meet its working capital needs. We assume that the project will readily renew or replace the working capital facility at its maturity.

In addition, for the maintenance of the assets and replacement capital expenditure, the project) maintains escrow accounts, into which it places the renewals component of the operation, maintenance, and renewal costs (OMRC) and of the station use charge. The cost-pass-through nature of these charges largely mitigates life cycle risk. The combined balance on these escrow accounts stood at £76 million in the financial year ending March 30, 2016, and we forecast that this will rise to approximately £120 million at the end of the next control period in March 2020.

Outlook

The stable outlook reflects our view that the project will continue to deliver strong operational performance and benefit from a supportive and stable regulatory regime. The outlook also factors in the project's strong competitive position as operator of the sole high-speed train route connecting the U.K. to continental Europe, as well as our view that the minimum DSCR of at least 1.4x under our base case is sustainable. The rating is supported by the project's strong contractual structure, including advance train path reservation and payment by train operators and an agreement guaranteed by the U.K. government underpinning domestic train paths. These help to provide performance resilience against stressed operating conditions.

Downside scenario

We could lower the ratings if the project's financial profile weakened, for example, as a result of operational underperformance or reduced demand for international train paths, causing the minimum DSCR to fall below 1.4x and a weakened resilience to stress scenarios. A sustained weak inflationary environment could also lead to deterioration in the project's financial performance given HS1's inflation-linked revenue receipts compared to a predominantly fixed-rate debt profile.

We could also lower the ratings if the project becomes exposed to additional counterparty risk as a result of a fall in the ratings on swap counterparties or working capital facility providers to below the project rating level, or if the project incurs additional exchange-rate risk due to the issuance of a further tranche of foreign currency-denominated debt with a lower-rated swap counterparty. The account bank counterparty must be rated at least 'BBB-' to not constrain our 'A-' issue credit rating on the notes.

Upside scenario

Following the new debt issuance, a positive rating action is unlikely, in our view, without a further significant improvement in our base-case projection of the minimum average DSCR. In order for us to consider an upgrade, we would need to see a minimum ADSCR of around 1.8x.

Ratings Score Snapshot

Operations Phase SACP (Senior Debt)

- Operations phase business assessment: 4 (1=best to 12=worst)
- Preliminary operations phase SACP: a-
- Downside analysis: aa (+1 notch)
- Debt structure: Negative (-1 notch)
- Liquidity: Neutral (no impact)
- Comparable ratings analysis: Neutral (no impact)
- Operations Phase SACP: a-

Modifiers (Senior Debt)

- Parent Linkage: Delinked (no impact)
- Structural protection: Neutral (no impact)
- Senior debt issue rating: A-

Related Criteria And Research

Related Criteria

- Key Credit Factors For Road, Bridge, And Tunnel Project Financings, Sept. 16, 2014
- Project Finance Operations Methodology, Sept. 16, 2014
- Project Finance Transaction Structure Methodology, Sept. 16, 2014
- Project Finance Framework Methodology, Sept. 16, 2014
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Project Finance Construction And Operations Counterparty Methodology, Dec. 20, 2011

Related Research

- Presale: High Speed Rail Finance PLC, Sept. 26, 2016

Ratings List

New Rating

High Speed Rail Finance PLC	
Senior Secured	A- (prelim)/Stable

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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.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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