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Rated Debt Related To Three U.K. Transportation Infrastructure Assets On Negative Outlook On Rising Brexit Risks

Primary Credit Analysts:
Beata Sperling-Tyler, London (44) 20-7176-3687; beata.sperling-tyler@spglobal.com
Tania Tsoneva, CFA, Dublin (44) 20-7176-3489; tania.tsoneva@spglobal.com
Luisina Berberian, Madrid +(34) 91-788-7200; luisina.berberian@spglobal.com

Secondary Contacts:
Rachel C Goult, Paris (33) 06-2009-1284; rachel.goult@spglobal.com
Michela Bariletti, London (44) 20-7176-3804; michela.bariletti@spglobal.com

OVERVIEW

- The framework for the future relationship between the EU and the U.K. has become increasingly uncertain and may affect the operating environment for transportation infrastructure assets with significant exposure to EU-U.K. traffic.
- Heightened short-term uncertainty around transport policies and the potential for weaker macroeconomic conditions under our different Brexit scenarios--including Britain leaving the EU in March 2019 with no deal--may weigh on U.K. transportation infrastructure assets' operating and financial performances.
- As a result, we are revising the outlooks to negative from stable on the rated debt related to three U.K. infrastructure assets: the two largest airports Heathrow and Gatwick, as well as the Eurotunnel. We are affirming all issue credit ratings.

RATING ACTION OVERVIEW

On Dec. 19, 2018, S&P Global Ratings revised the outlook on the rated debt related to U.K.-based transportation infrastructure issuers Gatwick Funding

Ltd., Heathrow Funding Ltd., Channel Link Enterprises Finance PLC (the Eurotunnel's project finance) as well as the outlook on the issuer credit rating on Getlink PLC (the ultimate parent of Eurotunnel Holding SAS) to negative from stable. We affirmed all the ratings.

We affirmed the 'A-' rating on U.K. air traffic controller NATS (en Route) plc. The outlook remains negative.

We affirmed our 'A-' rating on Irish airport DAA plc. The outlook remains positive.

RATING ACTION RATIONALE

The negative outlook revisions to the debt of certain U.K.-based transportation infrastructure issuers reflects the heightened operational and financial risks resulting from uncertainties surrounding the future relationship between the U.K. and EU. Infrastructure assets are particularly sensitive to potential Brexit-related macroeconomic disruptions because passenger traffic and the propensity to travel and trade, in aviation and rail, is closely linked to disposable incomes, currency fluctuations and economic growth. Under our no deal Brexit scenario (see "Countdown to Brexit: No Deal Moving into Sight, Oct 30, 2018") we forecast the U.K. to enter into a moderate recession with a cumulative loss of about 5.5% GDP over our baseline forecast over 2020-2021. We expect that sterling could depreciate by as much as 15%. Negative pressure could build on financial performance and, consequently, rating headroom. In our view, the operating environment for infrastructure assets, notably those with significant exposure to U.K.-EU traffic is equally less predictable due to uncertainties around transport policies and the possible disruption to traffic if the U.K. leaves the EU without a deal on March 29, 2019.

We continue to see extended disruption in traffic as unrealistic given the contingency plans by the European Commission and the commitment of the U.K. to keep traffic flowing, however we note that no agreement has been signed to date.

While traffic disruption and the macroeconomic factors related to a no-deal Brexit scenario are not currently part of our base case, we have analyzed several stress cases for transportation infrastructure assets with significant U.K.-EU bound traffic. The outcomes show that our base-case forecasts for certain assets are now more at risk due to limited financial headroom, within the context of a likely weaker business environment; together with potential operating exposure to a disruptive Brexit (see "Countdown To Brexit: Growing Uncertainty Means Higher Operating Risk For Transportation Infrastructure," published today on RatingsDirect). We note that companies are mitigating against any potential operational impact of a disruptive Brexit; they are proactively managing near-term debt maturities and funding needs, thereby reducing refinancing risks. Other mitigating actions include voluntary dividend reductions, cost-containment programs, or postponing non-committed

capital expenditure (capex). If successful, these measures could support ratings if sufficiently mitigating the potentially increasingly difficult industry and economic environment.

AIRPORTS

GATWICK FUNDING LIMITED

The rating affirmation on the Class A debt reflects our base-case forecast that the issuer of Gatwick Airport, Gatwick Funding Limited (GFL), will achieve S&P Global Ratings-adjusted weighted-average funds from operations (FFO) to debt above 10% in 2018-2020, even when factoring in a slowdown in passenger growth to an annual 1%-2%. Aeronautical tariffs will grow in line with the retail price index (RPI) plus 2%. We also recognize Gatwick's financial leeway with comparatively moderate leverage (debt to RAB of 58% at Sept. 30, 2018) and continued positive free cashflow supported by modest forecast capex of £240 million-£250 million annually in FY2018-FY2020 (financial year ending March 31). Although we understand management intends to pay dividends corresponding to maintaining financial leverage of up to 65% net debt to transfer RAB, we believe there is significant flexibility to lower dividends to maintain financial headroom if earnings are weaker than expected. Furthermore, Gatwick is likely to benefit from its strong competitive position and strong management team, which has previously delivered on operational and cost efficiencies.

OUTLOOK

The negative outlook revision on the Class A debt reflects the increased uncertainty on future traffic, notably in a no deal Brexit scenario if combined with more adverse and prolonged economic conditions. This is particularly relevant for Gatwick given its high exposure to EU-bound traffic (63% of total outgoing traffic in 2017). Traffic disruption equally could weigh on metrics. We continue to see extended disruption in traffic as unlikely given the European Commission's contingency plans and the U.K. government's commitment to keep traffic flowing.

We recognize the degree of financial headroom Gatwick enjoys, and we forecast that GFL's weighted-average FFO to debt in FY2019-FY2021 may drop to just below 10%, depending on the stress case and without fully considering the effects of potential mitigating actions such as a more moderate dividend policy or any other action.

We expect that any change in the shareholding of Gatwick Airport group will not negatively affect the current shareholders' financial policy of targeting a net debt-to-RAB ratio of up to 65% by maintaining a balance between investment to support traffic growth, new funding, and dividends.

DOWNSIDE SCENARIO

We could lower our rating on the Class A debt if Gatwick Airport's weighted-average FFO to debt falls below 10% and the actual Brexit scenario and its impact on future traffic, the operating environment, and macro-economic conditions is more severe than we anticipate. This could happen if passenger volumes do not reach expected levels, for example due to traffic disruption or growth slowdown resulting from Brexit. We will factor into our analysis any actions that management could take, such as redeploying aircraft on other routes, reducing operating costs, delaying non-committed capex, and reducing dividends.

We currently see a weighted-average FFO to debt of at least 8% as commensurate with a one-notch downgrade.

UPSIDE SCENARIO

We would revise the outlook to stable if the operating as well as the U.K. macro-environment becomes more predictable such that we see traffic as sufficiently resilient and operating performance supports our forecast that GFL will generate weighted-average FFO to debt sustainably above 10% in FY2019-FY2021. We would also factor in Gatwick Airport's shareholder intentions regarding leverage in case of a change of ownership.

HEATHROW AIRPORT

Our rating affirmation on the debt issued by Heathrow Funding Ltd. (HFL) and secured on the assets of Heathrow (SP) Ltd. reflects our base case that weighted-average FFO to debt for the rest of the current regulatory period until 2020 is likely to stay above 6% for total class A and class B debt and above 8% for the class A debt. Our base-case scenario is underpinned by flat traffic growth, reflecting Heathrow's capacity constraints, aeronautical tariffs growing at RPI -1.5% over the remaining Q6 regulatory period and annual capex of £800 million-£900 million in FY2018-FY2020.

Heathrow is likely to benefit from its excellent competitive position supporting the resilience of its traffic volumes, as well as a strong management team focused on increasing retail revenue and delivering cost efficiencies.

OUTLOOK

The outlook revision on the Class A and the Class B debt issued by Heathrow Funding Ltd. reflects the increased uncertainty about future traffic performance, notably in a no-deal Brexit scenario if combined with more-adverse and prolonged economic conditions. This is relevant for Heathrow Airport because of its moderate exposure to EU-bound traffic (36% of total outgoing traffic in 2017).

Traffic disruption equally could weigh on metrics. We continue to see extended disruption in traffic as unlikely given the European Commission's contingency plans and the U.K. government's commitment to keep traffic flowing.

We recognize a degree of financial headroom that Heathrow enjoys, and we forecast that HFL's weighted-average FFO to debt may drop to about 7% for the Class A debt depending on the stress case. Potential mitigating actions such as a more moderate dividend policy or drawing of class B debt already available in the group could offset the impact, if sufficient and timely implemented.

DOWNSIDE SCENARIO

We could lower the ratings on the Class A and the Class B debt by one notch if weighted-average adjusted FFO to debt deteriorated to below 8% for the class A debt or below 6% for the class B debt. We could also lower the ratings if group leverage increases from current levels of less than 70% in terms of debt to RCV for the class A debt or less than 80% debt to RCV for the class B debt. This will reduce financial covenant headroom, which sets the maximum leverage triggers at 72.5% debt to RAB for class A and 82.0% for class B at HFL. We will factor into our analysis any actions that management could take such as reducing leverage at the HFL level, reducing operating costs, delaying non-committed capex, and reducing dividends.

UPSIDE SCENARIO

We would revise the outlook to stable if the operating as well as the U.K. macro environment becomes more predictable such that traffic and operating performance support our forecasts that weighted-average FFO to debt for the rest of the current regulatory period until 2020 is likely to stay above 6% for total class A and class B debt and above 8% for the class A debt.

RAIL

CHANNEL LINK

The rating affirmation on the debt issued by Channel Link Enterprise Finance PLC (CLEF) reflects our expectation that the Fixed Link project (the Channel Tunnel crossing) will continue to deliver resilient operational performance with senior annual debt service coverage ratios (ADSCRs) under our base case of at least 1.40x and average ADSCRs of at least 1.9x through the life of the debt. Our ratings continue to be supported by the Channel Tunnel's strong competitive position, underpinned by an exclusive concession to operate the only fixed transportation link between the U.K. and France. Furthermore, the management team is strong, and has previously dealt with disruptions such as fire and more recently the migrant crisis.

OUTLOOK

The negative outlook on the 'BBB+' issue rating and on the SPUR reflect the risk of CLEF's ADSCRs dropping below 1.40x due to traffic and shuttle services disruption over the Channel Tunnel or due to more adverse economic conditions related to Brexit uncertainties.

The stable outlook on the 'AA' rated class G3 and G6 notes reflects that on AGE, and will move in line with the long-term rating on the insurer.

DOWNSIDE SCENARIO

We could lower the issue rating and SPUR on the notes by one or more notches if we assess that the project's operational risk has increased, for example due to a substantial decrease in traffic patterns or shuttle services, leading to a weaker competitive position. A downgrade could also occur in the case of a no deal Brexit leading to major operational disruption. We could also lower our ratings if the project's financial profile deteriorated, for example as a result of operational underperformance, or if post-Brexit disruption leads to reduced demand for international train services, or currency volatility, causing the minimum ADSCR to fall below 1.4x and a weakened cash flow resilience to our downside stress scenarios.

UPSIDE SCENARIO

We would revise the outlook to stable if the operating as well as the U.K. macro environment becomes more predictable such that traffic and operating performance support our current view of operating risk and our forecasts of senior ADSCRs under our base case of at least 1.40x and average ADSCRs of around 1.9x through the life of the debt.

GETLINK

The rating affirmation reflects our base case that the holding company of the Channel Tunnel concession, Getlink, will maintain S&P Global Ratings-adjusted FFO to debt of 7%-9% in 2018-2020. We anticipate that the Channel Tunnel's operating company will pay a steady and gradually increasing dividend of at least €120 million in fiscal 2019. Furthermore, we anticipate that ElecLink will construct its 1 gigawatt (GW) power interconnector within budget and on time. This is to be commissioned in December 2019 and will generate at least €80 million-€100 million of revenues in the first few years after commissioning based on an 85% utilization rate.

OUTLOOK

The negative outlook revision reflects our expectation that Getlink's adjusted weighted-average FFO to debt in FY2019-FY2021 may drop below 7% as it derives all of its revenues from traffic over the Channel Tunnel link between the U.K. and the EU. Traffic disruption or more adverse economic conditions related to Brexit could see S&P Global Ratings-adjusted FFO to debt fall to 5%-7%, depending on the stress case. Dividend distributions from the concession might drop to nil from the expected €190 million in 2019 and the holding company will need to rely fully on its fully funded debt service reserve account (DSRA) which covers 12 months of interest service (about €20 million).

DOWNSIDE SCENARIO

We could lower the rating if weighted-average adjusted FFO to debt were to deteriorate to below 6%, for example due to traffic disruption or a Brexit-related economic slowdown. Furthermore, if the concession business trends closer to the dividend lock-up ratios, it could indicate the higher likelihood of a dividend interruption for Getlink, although the dedicated debt service reserve available to Getlink noteholders somewhat mitigates this risk.

We would also consider a negative rating action if, for instance, ElecLink experiences construction delays or cost overruns resulting in weaker-than-expected cash flow generation.

UPSIDE SCENARIO

We would revise the outlook to stable if the operating as well as the U.K. macro-environment becomes more predictable such that traffic and operating performance support our forecasts that Getlink's weighted-average FFO to debt in FY2019-FY2021 will stay above 7% and the holding company will receive a steady dividend from the concession asset.

We also affirmed the following ratings with unchanged outlooks:

NATS

The rating affirmation on NATS (En Route) plc (NERL), the sole air traffic controller in U.K. airspace and the eastern part of the North Atlantic, reflects our expectation the company will operate with significant financial headroom compared to our guideline of S&P Global Ratings-adjusted FFO to debt above 18%. Brexit effects are limited because arrivals and departures from the EU are estimated to represent about 27% of NERL's revenue. Our base-case operating scenario for NERL includes a mild decline in revenues and EBITDA for the next few years, because further price reductions should be applied up to the end of RP2 (2015-2019).

OUTLOOK

The outlook remains negative, reflecting our view that we could lower the rating if we lowered the rating on the U.K. by more than one notch. It also reflects the potential effects of Brexit on the country's economic performance and air traffic levels, as well as the regulatory regime on the company's operations. It is currently within the framework of the European Commission's Single European Sky.

The stable outlook on the long-term issue rating on NERL's €600 million senior secured bonds guaranteed by Assured Guaranty (London) plc (AG London; AA/Stable) reflects that on AG London.

DOWNSIDE SCENARIO

We could lower the ratings if financial performance deteriorates, notably if FFO to debt falls below 18%. This might occur if NERL generated lower cash flows than we expect, or raised more debt to undertake larger investments or acquisitions than we assume in our base case. All else being equal, we could also lower the ratings if we revised our opinion on NERL's importance to the U.K. government and the likelihood that it would provide extraordinary support to NERL, if needed.

UPSIDE SCENARIO
We could revise the outlook to stable if the impact of Brexit on traffic levels is not disruptive, and our rating on the U.K. remains at least 'AA-'. The expected reduction in prices that NERL will be able to charge in RP3 is already incorporated into the current rating.

DAA PLC
The rating affirmation reflects our expectation that DAA will maintain its moderate leverage, with average S&P Global Ratings-adjusted FFO to debt of 45%-50% on average over 2018-2019, declining to about 30% thereafter. The ratios could weaken if DAA has raised debt to finance the construction of the North Runway and other capital investments after FY2020. While still under negotiation, aeronautical tariffs could be somewhat lower in the next regulatory period (2020-2024) because DAA's total revenues in the current regulatory period (2015-2019) benefited from a strong passenger traffic increase coupled with a material increase in domestic retail revenues.

OUTLOOK

The positive outlook on Irish airport operator DAA reflects our view that, all else being equal, we could raise the ratings on DAA by one notch if the company maintains S&P Global Ratings-adjusted FFO to debt above 30% on a sustainable basis, while completing significant investments, and managing uncertainties regarding aeronautical charges in the next price control period. While DAA generates more than 30% of its traffic from the U.K., we anticipate that its S&P Global Ratings-adjusted weighted-average FFO to debt in FY2019 will remain within 40%-45% in case of traffic disruption and more adverse macroeconomic conditions related to Brexit.

Taking into consideration the new regulatory period starting in 2020, DAA has initiated negotiations with the regulator, and we expect the latter will issue a preliminary draft in April 2019, with the final regulations expected in September 2019.

DOWNSIDE SCENARIO

We could revise the outlook back to stable if the company's credit metrics are less than we currently forecast, notably if weighted-average FFO to debt is not sustained above 30%. We think this could occur if the company increased its investments, or if significant tariff cuts depressed its earnings and were

not compensated by an increase in passenger numbers. In our view, passenger numbers could also be affected by Brexit, for example due to unfavorable changes to the liberalized air service agreements or economic regulation in the Common Travel Area, or if the macroeconomic environment becomes less favorable, threatening tourism growth in Ireland.

RELATED CRITERIA

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
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- Criteria - Insurance - Bond: Standard & Poor's Methodology For Setting The Capital Charge On Project Finance Transactions, Sept. 12, 2007

Ratings Affirmed; Outlook Action

	To	From
Getlink		
Issuer Credit Rating	BB/Negative/--	BB/Stable/--
Senior Secured		
Local Currency	BB	
Recovery Rating	3(65%)	
Channel Link Enterprises Finance PLC		
Senior Secured	BBB+/Negative	BBB+/Stable
SPUR	BBB+/Negative	BBB+/Stable
Heathrow Funding Ltd.		
Senior Secured	A-/Negative	A-/Stable
Senior Secured	BBB/Negative	BBB/Stable
Gatwick Funding Ltd.		
Senior Secured	BBB+/Negative	BBB+/Stable

Ratings Affirmed

Channel Link Enterprises Finance PLC	
Senior Secured	AA/Stable
DAA PLC	
Issuer Credit Rating	A-/Positive/A-2
Senior Unsecured	A-
DAA Finance PLC	
Senior Unsecured	A-
NATS (En Route) PLC	

Issuer Credit Rating	A+/Negative/--
Senior Secured	A+
Senior Secured	AA/Stable

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