

HS1 acquisition, UK

Alexandra Dockreay

15/09/2017

A pool of fund managers formerly focused on PFI/PPP have become eager to buy, and hard to beat, when it comes to core, regulated infrastructure assets in Europe. So when InfraRed Capital Partners and Equitix bought the High Speed One UK rail concession this month, it followed the recent script. Less typical was the buyers' choice of Goldman Sachs to underwrite all of the long-term debt for the acquisition.

The value debate

The UK government sold a concession to operate and maintain the stretch of railway and several stations between the St. Pancras station in central London and Ashford International in 2010 to two Canadian pension funds.

The stretch is the UK's first high speed rail line and had cost the government £5.7 billion to build (or £6.2 billion undiscounted). The Canadian pension funds paid £2.1 billion to buy a 30-year concession from the UK government, with the consideration exceeding expectations by £600 million.

Almost seven years later the Canadians have sold the concession to the highest bidder for an enterprise value of roughly £3.3 billion. The higher valuation paid, some have said, is a function of yields having come down.

But there are plenty of critics of the 2010 sale. Many believe the government could have transferred more operational, maintenance and revenue risks to the owners. The government provided plenty of guarantees on the revenues, such as on a basic level of traffic, and under the terms of the contract the operations and maintenance expenditures can be passed on to Network Rail. The original contract structure has passed on to the new owners broadly unchanged.

Today's core infrastructure bidders

The Office of Rail and Road (ORR) is the economic and safety regulator for the 30-year concession for the line, which expires on 31 December 2040. ORR regulates track access charges, while the Department for Transport regulates station access charges. Elements of HS1's returns are RPI inflation-linked.

The partially-regulated and index-linked concession structure suits the low-risk investment profile of its new fund owners neatly. And assets like this have been increasingly targeted by those formerly PFI/PPP-focused infrastructure funds over the last couple of years.

InfraRed's listed fund HICL Infrastructure made a recent debut in the water utility space on the acquisition of [Affinity Water](#) in May this year. At the time InfraRed said HICL had reached a critical mass to allow it to start adding this type of large utility investment to its portfolio. Equitix lists online its "utility infrastructure" investments to date, which include an OFTO but are mostly renewable energy projects, while other investments in its portfolio have been predominantly PPPs/PFIs.

The HS1 sale launched at the end of 2016, and by the end of the process the eventual winners were going head-to-head against a rival consortium of a similar ilk. It consisted of Dalmore Capital, Amber Infrastructure and DIF. All of these managers started out investing in PPPs and PFIs, but more recently have invested in some regulated assets including the regulated sewer project [Thames Tideway Tunnel](#) in 2015 which they all took shares in. Then Amber and Dalmore were buyers of [National Grid Gas Distribution](#), while DIF took stakes in German gas distributor [Thyssengas](#) and the aforementioned Affinity Water.

The auction

The former owners of HS1, Ontario Teachers' Pension Plan and OMERS Infrastructure (named Borealis Infrastructure until this month), fired the gun on the sale of HS1 in December 2016. They had been approached by interested parties and stated that they were assessing their options.

The sellers then mandated Bank of America Merrill Lynch and Linklaters to advise them on a sale.

The two consortia already mentioned were joined during the bidding process by a third contender Groupe Eurotunnel. Eurotunnel had tried to buy HS1 back in 2010, and as its UK-France tunnel connects to the HS1 rail line it has clear motivation for taking it over. But Eurotunnel dropped out before the sale got as far as final bids.

There was another drop out later on, when DIF exited the consortium it had formed with Amber, Dalmore and GLIL (a partnership between Greater Manchester Pension Fund and London Pension Fund Authority). This group went hard on the leverage initially, a couple of lender sources have said, seeking in the region of £1 billion of acquisition debt. But as the auction wore on this was whittled down to an amount close to that of the winners. The Dalmore/Amber/GLIL team's advisers were RBC, DC Advisory and Ashurst.

The final bids went in on 13 July and within only a day InfraRed and Equitix were announced as the victors. Various sources say the opposition were quite shocked at the clear blue water between their equity offers. *IJGlobal* has learned it was in the region of £150 million to £200 million difference.

Acquisition break-down

The winning bid implies an enterprise value of roughly £3.3 billion for HS1 Ltd. This is including £1.9 billion of existing debt which remains in place, a £900 million equity cheque and roughly £500 million of holding company debt raised to support the acquisition.

The acquisition completed on 6 September 2017, after signing of the deal was announced on 14 July.

InfraRed managed to bring on board an assortment of Korean institutional investors as well as UK local authority pension funds as co-investors on the equity.

National Pension Service of Korea (NPS) stumped up a commitment for 30% of the equity, which will be managed by InfraRed. With some uncertainty that this would all be signed off in time by NPS as it worked through its lengthier internal approvals, InfraRed and Equitix had arranged a short bridge loan as a safety net to cover the portion, though it was not needed ultimately.

The £900 million of equity breaks down as:

- Equitix – 35%
- HICL Infrastructure – 21.8% for £196 million
- NPS – 30%
- Korean and British co-investors with InfraRed – 13.2% for roughly £120 million

The roughly £500 million of holdco debt, meanwhile, was for the most part underwritten by Goldman Sachs.

Near to £450 million is long-term debt maturing in 2038, underwritten by Goldman Sachs. This is split into a fixed-rate

tranche, and an inflation-linked debt tranche. The fixed-rate piece accounts for the majority of this debt and has so far been syndicated to the bank ING and institutional lenders Legal & General Investment Management (LGIM) and Macquarie's debt business. Pricing on this fixed-rate piece comes in at an all-in coupon close to 3%, and the benchmark used is gilts.

Rounding the holdco debt to around £500 million is a smaller bank facility of around £50 million with a five-year tenor. This serves as a liquidity line and comes from MUFG, SMBC and Santander. The pricing for this floating rate debt is said to be in the region of 120bp to 130bp.

Macquarie Capital was financial adviser for the buyers, while Allen & Overy was legal adviser. Linklaters and Ashurst had roles advising lenders.

The asset

HS1 Ltd is concession holder through to the end of 2040 for a 109km rail link including tunnels and bridges, as well as four stations along its route at St. Pancras in central London, Stratford and Ebbsfleet in east London and Ashford in Kent. The line is built to handle trains travelling at 300km per hour.

The principle train operators using the line are Eurostar, whose trains go on into the Eurotunnel to emerge in France, and UK operator Southeastern. The charges they pay are partially regulated, and partly depend on train volumes.

In the year up to 31 March 2017, HS1 Ltd's earnings before interest, tax, depreciation and amortisation (EBITDA) were £185 million and turnover was £305.4 million. Taking the rough £3.3 billion enterprise valuation of the deal, the EBITDA multiple would come out at nearly 18x.

New competitive levels

Everybody knew this deal would be competitive – it's a regulated UK infrastructure trophy asset. But some in the market are saying a new precedent has been set in how competitive some infrastructure funds are willing to be, given how far the winners beat peers Dalmore and Amber on price. This cluster of infrastructure fund managers have typically priced closely in previous auctions.

One person with a role on the deal suggests that some of these managers might be seen bidding in a fresh UK auction if Cory comes up for sale. Its principal asset is the Riverside Energy from Waste Plant, and though in a riskier sector, its business is underpinned in large part by a long-term contract with Western Riverside Waste Authority. Following a [recent refinancing](#), the Cory sale is widely touted to launch later in 2017 or during 2018.

Thank you for printing this article from IJGlobal.

As the leading online publication serving the infrastructure investment market, IJGlobal is read daily by decision-makers within investment banks, international law firms, advisory firms, institutional investors and governments.

If you have been given this article by a subscriber, you can contact us through www.ijglobal.com/sign-in, or call our London office on +44 (0)20 7779 8870 to discuss our subscription options.