S&P Global Ratings

Research

Presale:

Arqiva PP Financing PLC

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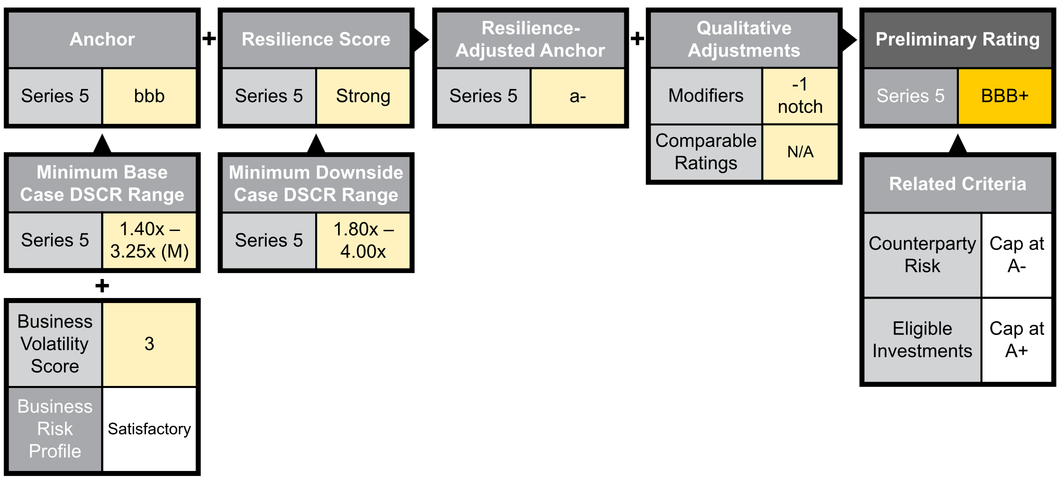

DSCR--Debt service coverage ratio.(M)--Medium end of the range.N/A--Not applicable.

Ratings

Class	Preliminary rating*	Balance (mil. £)	Leverage ratio§	Legal final maturity date
Series 5	BBB+	92.0	3.35	June 30, 2031

Note: This presale report is based on information as of May 22, 2023. The ratings shown are preliminary. Subsequent information may result in the assignment of final ratings that differ from the preliminary ratings. Accordingly, the preliminary ratings should not be construed as evidence of final ratings. This report does not constitute a recommendation to buy, hold, or sell securities. *Our ratings on the notes address timely payment of interest and timely payment of principal. §Based on the FY2022 S&P adjusted EBITDA of £309 million (post-exceptionals).

Executive Summary

S&P Global Ratings today assigned its 'BBB+' preliminary credit rating to Arqiva PP Financing PLC's new fixed-rate £92.0 million series 5 notes with a June 2031 legal final maturity date.

The rating we assign on the issue date will depend on receipt and satisfactory review of all final transaction documentation, including legal opinions, and conditions precedent being met.

The new issuance will result in a note leverage ratio of about 3.35x, based on fiscal year ending June 2022 (FY2022) S&P adjusted EBITDA of £309 million (post-exceptionals).

Arqiva PP Financing was established so that Arqiva Financing No. 1 Ltd., the borrower under the pre-existing corporate securitization of Arqiva Group Parent Ltd.'s (the Arqiva group's) operating business, could raise funding through U.S. private placement (USPP) notes. The previous issuance, series 4, was in 2016. We understand that the new debt will be denominated in British pound sterling.

The transaction is a corporate securitization of the Arqiva group's operating business, which provides communications infrastructure and media services in the U.K. The Arqiva group provides much of the infrastructure behind TV, radio, satellite, and wireless communications in the country. Its customers include major U.K. broadcasters such as the BBC, ITV, Channel 4, Five, Sky, Discovery, BT, and Sony; and the independent radio groups Global Radio and Bauer Radio.

On receipt of the issuance proceeds, we understand that Arqiva PP Financing will in turn onlend them to Arqiva Financing No. 1, via an intercompany loan, which will incorporate terms that correspond with Arqiva PP Financing's obligations relating to the USPP notes. Once Arqiva Financing No. 1 has satisfied the covenant to pay, the intercompany loan will be discharged. The borrower will use the proceeds from the repayment of the intercompany loan to part-refinance the institutional term loan (ITL) and the European Investment Bank (EIB) loan issued by the borrower.

The note purchase agreement (NPA) will be designated as an authorized facility and a borrower bank facility. Therefore, the USPP noteholders will benefit from the same covenants, representations, and warranties protections given by Arqiva Financing No. 1 and the other obligors under the senior debt within the corporate securitization. Arqiva Financing No. 1's obligations will also be secured on the same terms as the borrower's other senior secured debt.

The series 5 USPP notes will rank pari passu with the USPP series 3 and 4 notes, the existing bonds issued by Arqiva Financing PLC, and the senior secured debt incurred directly by the borrower, including the European Investment Bank loan. Based on the information we have been provided with, we understand that the notes will mature in 2031 and be fully amortizing.

The transaction would likely qualify for the appointment of an administrative receiver under the U.K. insolvency regime. An obligor default would allow the noteholders to gain substantial control over the charged assets prior to an administrator's appointment, without necessarily accelerating the secured debt.

Overview Of New Issuance

Arqiva PP Financing will issue the new fixed-rate series 5 notes totaling £92 million. These new notes rank pari passu among themselves and with the existing senior notes and the senior secured debt incurred directly by the borrower.

Table 1

Sources and uses of funds

Sources	Mil. £	Uses	Mil. £
USPP Series 5	92.0	Part-redemption of the ITL and EIB loan	90.0
		Transaction fees/General Corporate Purposes	2.0
Total sources	92.0	Total uses	92.0

USPP--U.S. private placement. ITL--Institutional term loan. EIB--European Investment Bank.

Similar to the first four series, the USPP series 5 notes will be issued and documented under an NPA between the USPP noteholders, Arqiva PP Financing, Arqiva Financing No. 1, and the securitization's obligor group. According to the NPA's terms, Arqiva Financing No. 1, as primary obligor, will pay the USPP noteholders all principal, interest, and other amounts due under the USPP notes issued by Arqiva PP Financing (the covenant to pay). We expect that the NPA's terms will be subject to the terms of the common terms agreement (CTA), the security trust and intercreditor deed, and master definition agreement.

Notable Features

Table 2

Transaction notable features

Original closing date	February 2013
Last class tap issuance	November 2016
Payment frequency	Semiannually (June and December)
Senior notes repayment profile	Soft bullet: Interest only before expected maturity date and cash sweep amortization thereafter, as well as fully amortizing
Collateral	The issuer's obligations are primarily backed by future cash flows generated by the Arqiva group's operations
Security	The notes benefit from a shared security, ultimately benefiting under the loan agreements from first-ranking security fixed and floating charges over properties, shares, and accounts, and the ability to appoint an administrative receiver for the assets in the ring-fence structure.
Domicile	U.K.

Business Description

Arqiva provides essential communications infrastructure and media services in the U.K., operating in the U.K.'s broadcast, satellite, and mobile communications markets. It provides much of the U.K.'s infrastructure behind television, radio, satellite, and wireless communications.

Business Risk Profile

We have applied our corporate securitization criteria as part of our rating analysis on the notes in this transaction. Our view of the borrowing group's potential to generate cash flows is informed by our base-case operating cash flow projection and our assessment of its business risk profile (BRP), which is derived using our corporate methodology (see "Corporate Methodology," published on Nov. 19, 2013).

We continue to view the BRP of the Arqiva group as satisfactory. It has the following strengths:

- Good predictability of revenue and cash flows, owing to a high proportion of its revenues being tied to long-term contracts, some of which contain retail price inflation (RPI)-linked increases. Notably, as of June 2022, the Arqiva group's order book amounted to about £3.2 billion. Additionally, historical contract renewal rates have been high.
- Its client base consists largely of investment-grade companies (rated 'BBB-' or higher), with a large share of revenues from state-owned broadcasters that have good standing in credit

markets, in our view.

Weaknesses and mitigating factors:

- Limited geographic diversification, with operations principally focused on the U.K. market. This is partly offset by its strong market position and the monopoly-like characteristics of the TV broadcasting business.
- The regulatory environment for spectrum allocation among alternative uses is still evolving, which could result in changes to the revenue mix and profitability.
- The economic viability of competing technologies could improve over time, or new technology may emerge and erode the borrower's market position. Although this is a threat to the borrower's business, we view it as a long-term risk, at which point the borrower is likely to have reduced debt.

Rating Rationale

Our base-case EBITDA and operating cash flow projections for financial years (FY) 2023-2026 and the company's satisfactory BRP rely on our corporate methodology.

Debt service coverage ratio (DSCR) analysis

Our cash flow analysis serves to both assess whether cash flows will be sufficient to service debt through the transaction's life and to project minimum DSCRs in our base-case and downside scenarios.

We typically view liquidity facilities and trapped cash (either due to a breach of a financial covenant or following an expected repayment date) as being required to be kept in the structure if: (1) the funds are held in accounts or may be accessed from liquidity facilities; and (2) we view it as dedicated to service the borrower's debts, specifically that the funds are exclusively available to service the issuer/borrower loans and any super senior or pari passu debt, which may include bank loans (see "Related Criteria").

Base-case forecast

Revenues declined by 3.3% in FY2022 (June end), due to a reduction in 700MHz clearance revenues as when the program reaches completion, prices decline for contract renewals in Digital Platforms. The revenue decline also reflected the loss of a satellite and Digital Platforms customer, Russia Today, following sanctions in March 2022.

In our view, revenue performance in FY2023-FY2026 in the broadcast (terrestrial broadcast, digital platforms, and satellite and media) and utilities (smart metering) operating segments will be broadly in line with management's expectations. Arqiva's revenue visibility is supported by its media distribution contracted order book of £2.8 billion. We also view execution risk as relatively limited for new revenue, most of which will come from the utilities segment, due to reasonable assumptions on new contract wins based on Arqiva's capabilities and track record. In addition, performance of the utilities (smart metering) segment in the first six months of FY2023 has already demonstrated an increase in revenue year-on-year due to the new water metering contracts driven by strong devices sales.

We expect revenue growth of about 0.1% in FY2023 followed by 7.3% in FY2024, thanks to double-digit revenue growth in the utilities (smart metering) segment because of some slippage from FY2023. We then assume slight revenue decline in FY2025.

Terrestrial broadcast: Revised forecast to high single-digit revenue growth in FY2023 mainly on the back of high levels of inflation, followed by low single-digit revenue decline in FY2024. TV and radio broadcast revenues benefit from indexation as most contracts are RPI-linked.

Digital platforms: We expect high single-digit revenue decline in FY2023 due to continued price declines for contract renewals based on a continued conservative view of the advertising market and the loss of the Russia Today stream, before returning to stable revenues over subsequent years.

Satellite and media: Broadly stable revenue expected in FY2023. Followed by a low double-digit revenue decline in FY2024 and broadly stable revenue streams after.

Utilities: A low single-digit revenue decline in FY2023. We expect this decline to be followed by about 20% revenue growth in FY2024. This reflects growth in contracted revenues from Anglian Water and Thames Water, CSPN, and new revenues from additional water metering wins in FY2023. Additional opportunities include Thames valley acceleration and new super growth initiatives.

In terms of profitability, Arqiva's S&P adjusted EBITDA margin increased to 52% in FY2022 from 51% in FY2021. Despite higher exceptional costs, as reflected in the company's profit and loss statement, which increased to about £30 million mainly associated to the Bilsdale fire (August 2021), revenue growth of low-margin device revenues from its smart metering business, coupled with an overall top-line revenue decline offset cost increases.

We expect Arqiva's adjusted EBITDA margin to remain broadly stable in FY2023 and decline to about 47%-50% in FY2023-FY2024.

Our management capital expenditures (capex) assumptions are unchanged as, in our view, they are realistic and are tied to maintenance and specific projects. We have included maintenance capex and both committed and uncommitted capex (as we believe the uncommitted capex is likely to become committed in the indicated periods). Following a one-off increase in its reported capex in FY2022 associated with Bilsdale fire, we expect about 15% decline in FY2023-FY2024 based on information provided.

Beyond FY2026, our base-case and downside EBITDA projections are based on our criteria for rating corporate securitizations, from which we then apply assumptions for capex and taxes to arrive at our projections for the cash flow available for debt service.

Our revenue assumptions are based on the contracted revenue and order book information that the Arqiva group provided to us as well as detailed information on the RPI linkage of contracts in each segment. We assume that it will maintain the contracts it has in place but that no new contracts will be signed. Our assumptions, indirectly, factor cost increases in line with RPI by applying a constant revenues margin assumption. Corporate and technology cost assumptions are in line with management's plan, and we assume maintenance capex in line with the company's projections. Notably, since no revenues from new contracts are assumed from FY2026, we assume only the maintenance capex required to support the contracted portion of revenue. We assumed that growth capex required to sustain the revenues during FY2023-FY2025 is spent and that forecast growth capex is included due to the technology investment needed to maintain the base-case cash flow level rather than for growth, with any assumptions for new contracts excluded from our cash flow projections.

We established an anchor of 'bbb' for the notes based on:

- Our assessment of the Arqiva group's satisfactory BRP, which we associate with a business volatility score of 3; and
- In our base-case DSCR analysis, we give credit to the borrower liquidity facility (BLF) as the facility is available both to the issuer and the borrower under the whole business securitization (both of them are listed as borrowers under the liquidity facility agreement).

Downside scenario

Our downside DSCR analysis tests whether the issuer-level structural enhancements improve the resilience of the transaction under a stress scenario. After considering its satisfactory BRP, sizable order book of long-term RPI-linked contracts, and RPI-linked escalation fees that bring visibility in terms of prices, a 17% decline in EBITDA from our base-case is appropriate for the Arqiva group, in our view. It reflects potential technological changes that could affect its margins.

Our downside DSCR analysis resulted in a strong resilience score for the notes. The combination of a strong resilience score and the 'bbb' anchor derived in the base case results in a resilience-adjusted anchor of 'a-' for the notes.

We also give credit to the BLF in our downside scenario since it is also available to the issuer directly upon insolvency of the borrower, which would not be a draw-stop under the liquidity facility agreement. Drawings made by the issuer for an issuer liquidity shortfall amount would be repaid by the borrower under the borrower's pre-enforcement priority of payments, by way of the issuer/borrower facilities fees.

The £150 million liquidity facility balance represents a significant level of liquidity support, measured as a percentage of the current outstanding balance of the notes it supports. However, it is available to both the borrower and the issuer. We did not grant an additional notch of uplift to the notes despite the presence of liquidity support in excess of 10% of debt. Because we give credit to the facility in our base case, no additional notch is warranted.

Our specific conclusions for each of the five analytical steps in our ratings process for the notes are provided in the following table.

Table 3

Credit rating steps

Step	Result	Comment
Step 1		
Eligibility conditions	Met	This transaction continues to meet the eligibility conditions, which include bankruptcy remoteness and asset isolation, replaceability of the management team, compatibility with long-term cash flow projections, sufficient liquidity, and isolation from refinancing risk. This allows us to rate through the insolvency of the operating company and differentiate the rating on the corporate securitization debt from the creditworthiness of the operating company.
Step 2		
Business risk profile	Satisfactory	See "Business Risk Profile" above.
Business volatility score	3*	The borrowing group's business risk profile maps to an unadjusted business volatility score of '3'*
Base-case cash flow assumptions	See table above	

Table 3

Credit rating steps (cont.)

Step 3

	USPP Series 5	
Minimum base-case DSCR range (x)	Mid-range of 1.40x - 3.25x	Principal and interest are fully paid in this scenario according to the terms of the transaction.
Anchor	bbb	Determined in accordance with table 1 of our corporate securitization criteria.
Minimum downside case DSCR range (x)	1.80x - 4.00x	Principal and interest are fully paid in this scenario according to the terms of the transaction.
Resilience score	Strong	Determined as per table 3 of our corporate securitization criteria.
Resilience-adjusted anchor	a-	Determined as per table 4 of our corporate securitization criteria.
Liquidity adjustment	No adjustment	The £150 million liquidity facility balance represents a significant level of liquidity support, measured as a percentage of the current outstanding balance of the notes it supports. However, it is available to both the borrower and the issuer. We did not grant an additional notch of uplift to the notes despite the presence of liquidity support in excess of 10% of debt. Because we give credit to the facility in our base case, no additional notch is warranted.
Step 4		
Modifier analysis	-1 notch	None of the amortizing classes of rated notes has a profile longer than 20 years. The longest-dated amortizing class is the 2013-1b notes with a legal final maturity in December 2032. However, the class 2014-1 notes have June 2030 ERD, which is around the seven-year ERD window within which we would not adjust the resiliency-adjusted anchor. However, there are mitigating factors that we considered, specifically:--The Arqiva group's BRP is satisfactory;--Most of the Arqiva group's order book is linked to long-term contracts that are linked to RPI;--Its competitive position is assessed as satisfactory; and--It owns and operates long-lived assets that are infrastructure-like.Therefore, we have applied a one-notch reduction in the resilience-adjusted anchor in our modifiers analysis.
Step 5		
Comparable rating analysis	No adjustment	There is no structural difference in Arqiva relative to other fully amortizing whole business securitization transactions in the U.K., as a result we do not apply any adjustment. Typically, if a class of debt is time-tranched, with each tranche ranking pari passu, we view the credit quality of all tranches as the same.

*The mappings from business risk profile to business volatility score are: Excellent=1; Strong=2; Satisfactory=3; Fair=4; Weak=5; and Vulnerable=6. DSCR--Debt service coverage ratio. ERD--Expected repayment date.

Counterparty Risk

We do not consider the derivatives, liquidity facility, or bank account agreements to be in line with our current counterparty criteria (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019). As a result, the maximum supported rating continues to be the lowest issuer credit rating (ICR) among the derivatives. Currently, the lowest rated providers are Commerzbank AG and Nomura International PLC, which acts as the issuer's swap provider.

However, our rating is not currently constrained by our ICR on any of the counterparties, including the liquidity facility, derivatives, and bank account providers.

Outlook

A change in our assessment of the company's BRP would likely lead to rating actions on the notes. We would require higher/lower DSCRs for a weaker/stronger BRP to achieve the same anchors.

Upside scenario

We do not currently anticipate an increase in the Arqiva group's BRP unless it enters a new market, its margin increases to above 60%, or an alternative use is identified for the towers other than digital television that would generate a supplemental revenue stream.

We may consider raising our rating on the notes if our minimum projected DSCR goes above 2.6:1 for the notes in our base-case scenario.

Downside scenario

We could lower our rating on the notes if we were to lower the BRP to adequate from satisfactory or if our minimum projected DSCRs fall below approximately 2.0x for the notes in our base-case scenario.

In addition, we would consider lowering our rating on the notes if we believe the relative weight of the obligors' secured creditors--which, in our view, may have interests and views not aligned with those of the noteholders--could heighten the risk of acceleration.

Surveillance

We will maintain active surveillance on the rated notes until the notes mature or are retired. The purpose of surveillance is to assess whether the notes are performing within the initial parameters and assumptions applied to each rating category. The transaction terms require the issuer to supply periodic reports and notices to S&P Global Ratings for maintaining continuous surveillance on the rated notes.

We view Arqiva group's performance as an important part of analyzing and monitoring the performance and risks associated with the transaction. While company performance will likely have an effect on the transaction, other factors, such as cash flow, debt reduction, and legal framework, also contribute to our overall analytical opinion.

Transaction participants

Arrangers	HSBC Bank PLC, Lloyds Bank PLC, and Bank of Nova Scotia (The)
Issuer	Arqiva PP Financing PLC
Operating holding company	Arqiva Group Holdings Ltd.
Obligors	The parent, the intermediate parent, the borrower, the operating holding company, and each principal subsidiary.
Liquidity facility providers	Bank of Nova Scotia (The) (London Branch), HSBC Bank PLC, and Santander UK PLC
Borrower hedge providers	Banco Santander S.A. (London Branch), Bank of America N.A., Bank of Nova Scotia, Barclays Bank PLC, Canadian Imperial Bank of Commerce, Commerzbank AG, ING Bank N.V., JPMorgan Chase Bank, N.A., Lloyds Bank Corporate Markets PLC, MUFG Securities EMEA plc, Nomura International PLC, and UBS AG (London Branch)
Borrower bank account bank provider	HSBC Bank PLC

Supporting ratings

Institution/role	
Borrower hedge providers	All rated hedge providers or their guarantors are currently rated 'A-' or above
Issuer and borrower liquidity facility providers	All liquidity facility providers or their guarantors are currently rated 'A' or above
Issuer and borrower bank account provider	A+/Stable/A-1

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Structured Finance | General: Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities , Dec. 22, 2020
- Criteria | Structured Finance | General: Methodology To Derive Stressed Interest Rates In Structured Finance , Oct. 18, 2019
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions , March 8, 2019
- Criteria | Structured Finance | ABS: Global Methodology And Assumptions For Corporate Securitizations , June 22, 2017
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology , March 29, 2017
- General Criteria: Guarantee Criteria , Oct. 21, 2016
- Criteria | Structured Finance | General: Global Framework For Assessing Operational Risk In Structured Finance Transactions , Oct. 9, 2014

- General Criteria: Methodology Applied To Bank Branch-Supported Transactions , Oct. 14, 2013
- Criteria | Structured Finance | General: Global Derivative Agreement Criteria , June 24, 2013
- General Criteria: Global Investment Criteria For Temporary Investments In Transaction Accounts , May 31, 2012
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

Related Research

- Credit Conditions Europe Q2 2023: Costs Rising To Cure Inflation, March 28, 2023
- Economic Outlook U.K. Q2 2023: Growth Eludes This Year Even As Inflation Eases, March 27, 2023
- Arqiva Financing PLC And Arqiva PP Financing Corporate Securitization Notes Ratings Raised To 'BBB+', Oct. 22, 2021
- Arqiva Financing PLC And Arqiva PP Financing U.K. Corporate Securitization Notes Ratings Affirmed At 'BBB', Dec. 22, 2020
- EMEA Retail & Restaurants: Industry Overview, Credit Trends, And Outlook, Oct. 16, 2020
- Credit Rating Model: Corporate Securitization Model For Arqiva Financing PLC, July 7, 2017
- Global Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016
- European Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016