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Ratings

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Summary:
The Go-Ahead Group PLC

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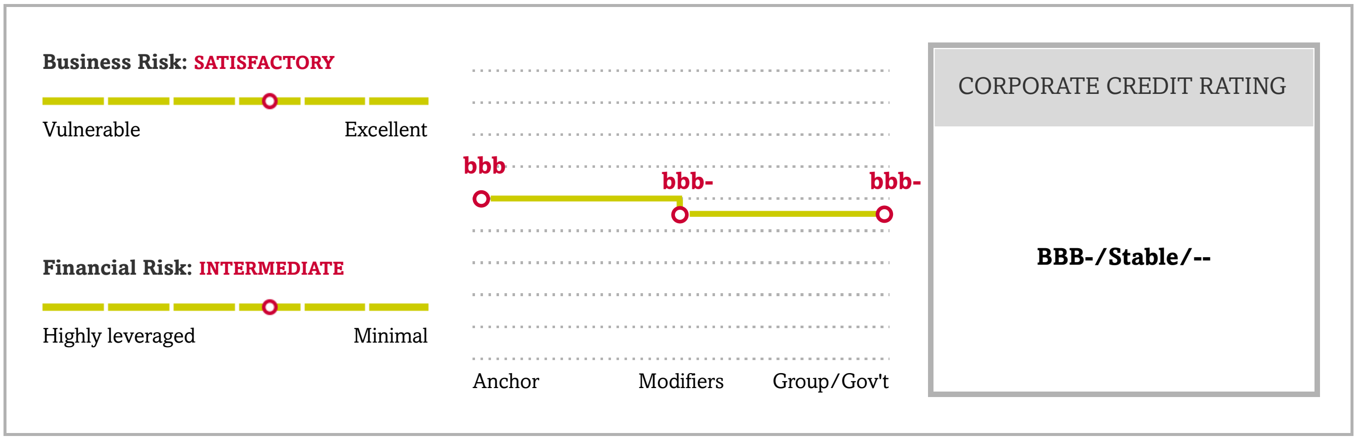

Rationale

Business Risk: Satisfactory	Financial Risk: Intermediate
• Largest bus operator in London, with one-quarter of the market, and an established position in the stable and cash-generative U.K. regional bus market, with a share of about 7%. • Diversity in the bus division, including operations in both the U.K. regional bus market and the regulated London bus business. • Relatively resilient demand in the bus division. As a lower cost method of transportation, buses are fairly resilient to economic cycles. • Largest operator in the U.K. rail market through its Govia partnership with France-based transport operator Keolis, a subsidiary of French rail operator SNCF Mobilites. Go-Ahead's position in this market is underpinned by supportive regulation.	• Strong financial metrics for the rating. However, Go-Ahead's financial policy is acquisitive and new contract wins could lead to a material increase in adjusted debt, although in rail this would be partly offset by the dividends paid by the new train operating company. • Robust and sustainable cash flow generation, supported by the resilience of demand for bus and rail transportation, some diversity in operations, and the flexible cost base of the group's regional bus business. • Variability in the dividends from the group's U.K. train operating companies, with these contracts having a limited life. • Shareholder-friendly financial policy, although we believe that Go-Ahead is committed to maintaining the current rating.

Outlook: Stable

The stable outlook on U.K.-based transport operator The Go-Ahead Group PLC (Go-Ahead) reflects S&P Global Ratings' view that the group will maintain its good operational and financial performance over the next two years, with a ratio of funds from operations (FFO) to adjusted debt of more than 23% on a weighted-average basis. Our assessment incorporates our expectation that there will be no material changes to U.K. transport policy, in particular through the planned Bus Services Bill, that would constrain Go-Ahead's operations.

The stable outlook also reflects our view that, while new investments or shareholder returns could affect the group's financial profile, it will not lead to credit metrics deteriorating below the level that we see as commensurate with the 'BBB-' rating.

Downside scenario

We could lower the rating if significant changes in Go-Ahead's operating environment constrain its competitive position, earnings, or cash flows. We could also downgrade Go-Ahead if investments, rail franchises, or shareholder returns depress the group's financial ratios such that they are no longer commensurate with the rating--notably, if FFO to debt falls to less than 23% or debt to EBITDA increases to more than 4x.

Upside scenario

We could upgrade Go-Ahead if FFO to debt and debt to EBITDA remain sustainably above 30%, and we view the group's financial policy more positively. This could follow a change in the group's bidding strategy, and the group deciding not to increase shareholder returns.

Our Base-Case Scenario

Assumptions

- S&P Global Ratings-adjusted revenue growth, which excludes the U.K. rail operations, of about 2% per year in the financial years ending July 1, 2017 and 2018, respectively.
- An adjusted EBITDA margin of about 20%-21% on our fully adjusted basis, excluding U.K. rail earnings and including the dividends that Go-Ahead receives from the train operating companies.
- Existing rail franchises running their term. The London Midlands franchise expires in October 2017, the Southeastern franchise expires in December 2018, and the Govia Thameslink Railway (GTR) franchise expires in September 2021.
- No other new franchises. This is because, in our view, it is difficult to predict which franchise Go-Ahead could secure, and on which terms.
- Forecast bus capital expenditure (capex) of about £115 million in financial 2017 and 2018, reflecting investment in the group's bus fleet.
- Dividends of £60 million-£65 million in financial 2017 and 2018.

Key Metrics

	2016a	2017f	2018f
FFO to debt*	32%	35%-37%	41%-43%
Debt to EBITDA*	2.5x	2.0-2.2x	1.7x-1.9x

*S&P Global Ratings-adjusted figures. FFO--funds from operations. a--Actual. f--Forecast.

We make a number of analytical adjustments to Go-Ahead's reported financials for 2016, notably:

- We deconsolidate Go-Ahead's U.K. rail operations, including revenues of £2.5 billion and EBITDA of £34 million.
- We include dividends that Go-Ahead receives from its U.K. train operating companies in EBITDA, and we include the undrawn portion of the liquidity facilities that Go-Ahead provides to its train operating companies in our debt figures.
- We deduct cash of £74 million that is not ring-fenced or held within the rail division (£562 million) from debt.
- We include debt-like obligations related to operating lease commitments of £25 million and postretirement benefits of £2 million, excluding deconsolidated U.K. rail operations.

Business Risk: Satisfactory

Go-Ahead derives the majority of its adjusted EBITDA from its bus operations, which we classify within the transportation cyclical industry. Our assessment of Go-Ahead's satisfactory business risk profile incorporates the low country risk of its operations, which take place in the U.K. It also reflects the group's excellent competitive position compared to other transportation cyclical companies.

Go-Ahead is the largest bus operator in London, with about one-quarter of the market. It also has a small but defendable position in the resilient and cash-generative U.K. regional bus market, with about 7% of the market and operates services that are predominantly located in the south of England.

The group is exposed to contract renewal risk, as well as to pricing risk, changes in passenger volumes, and fuel price fluctuations, which are influenced by overall economic and population growth and unemployment levels. This is, in our view, partially offset by good operating efficiency, high contract retention rates, and a largely variable cost base in the unregulated U.K. bus market.

Through its Govia (65% owned) partnership with France-based transport operator Keolis, it has a portfolio of rail franchises in the U.K. We understand that service levels have stabilised following periods of industrial action on the Govia Thameslink Railway (GTR), and that discussions between the unions continue. We would not expect the issues to affect Go-Ahead or Govia's ability to win new U.K. rail franchises, but will continue to monitor the situation.

Reported group revenues, which include rail operations, were £3.4 billion in financial 2016. We see the group's profitability (based on an S&P Global Ratings-adjusted EBITDA margin of 22.5% for financial 2016) as above-average for a transportation cyclical company.

Financial Risk: Intermediate

We believe that Go-Ahead's credit metrics will be strong for the rating during financial years ending July 1, 2017 and 2018, including FFO to debt of well above 23% on a weighted-average basis. Our base-case forecast shows that, on a weighted-average basis, FFO to debt will remain above 30%. However, this does not factor in the likelihood of any rail franchise renewals or new franchise wins that are currently being bid for, which could materially increase leverage. Please see "Other Credit Considerations" below.

Of Go-Ahead's three rail franchises, two have a fairly short remaining life. Go-Ahead is working on or awaiting the outcome of a number of bids in U.K., German, and Swedish rail, and Singaporean bus markets. New U.K. rail franchises will likely result in higher adjusted debt if the group takes on material contingent liabilities that are not adequately balanced by the dividend streams these franchises generate, especially as such liabilities are likely to be at the same level or even higher than for existing franchises. We note that dividends from the group's U.K. train operators can vary.

We note that Go-Ahead's reported debt was £312 million on July 2, 2016, and that reported debt to EBITDA for financial 2016 was 1.8x.

Liquidity: Strong

Our view of Go-Ahead's liquidity as strong reflects our estimate that sources of liquidity for the 12 months to Dec. 31, 2017, will exceed uses of liquidity by over 2x, and by more than 1.5x in the following 12 months.

Principal Liquidity Sources	Principal Liquidity Uses
• Unrestricted cash and liquid investments of about £74 million as of Dec. 31, 2016. • £85 million of availability under a revolving credit facility expiring in 2021. • FFO that we forecast to be over £200 million prior to our adjustments, except for U.K. rail. • The £200 million bonds are due in September 2017, for which the company has already agreed a £200 million bridging facility of the same amount to give timing options around the repayment of the bond.	• Low working capital requirement for the bus operations, including intra-year swings, of up to £5 million. • Maintenance capex of about £115 million. • £200 million of bonds as above. In our view, Go-Ahead benefits from well-established, solid relationships with banks, generally prudent risk management, a generally high standing in credit markets and the likely ability to absorb high-impact, low-probability events without refinancing.

Covenant Analysis

Financial covenants apply to some of the group's debt facilities. Under our base-case scenario, we forecast that headroom under these covenants will be in excess of 30% over the next two years.

Other Credit Considerations

The 'BBB-' rating on Go-Ahead incorporates our view that the group's strategy of bidding for new contracts in the U.K. and abroad could depress credit metrics beyond what we forecast in our base-case scenario. This is because new franchises may result in higher adjusted debt if the group takes on material contingent liabilities that are not adequately balanced by the dividend stream that these franchises generate. If the group does not find or win suitable new contracts, we believe that the cash-generative group would likely distribute additional cash to its shareholders. This risk is captured in our negative financial policy modifier. Although we believe that Go-Ahead's acquisitive strategy could result in weaker financial ratios, we also believe the group is committed to maintaining the current rating.

The U.K. government is continuing to discuss giving local authorities greater responsibility for local transport, including bus and rail, in particular through the planned Bus Services Bill. This could result in a potential shift from unregulated bus operations in some parts of the country. It is possible that, over the medium term, some regions where Go-Ahead operates may switch to a bus franchising system, similar to the way that bus services are provided in London. We note that Go-Ahead's share of the U.K. bus market is lower than that of its peers, at about 7%, whereas it has almost one-quarter share of the London bus market. Therefore, any changes to the U.K. bus market could also perhaps bring opportunities for Go-Ahead to bid for new contracts.

The effect of Brexit, and the associated risks to the U.K. economy, on passenger volumes and ticket pricing on the U.K. public transport network remains uncertain. Both regional bus and rail travel volumes tend to be somewhat influenced by overall economic growth and unemployment levels (particularly in the south of England): consumers visiting shops and commuters travelling to work. However, there are many trends at play (some offsetting), as there is an extremely diverse end-customer base, with travelers making journeys for many different reasons. As a lower cost method of transportation, volumes have been fairly resilient to economic cycles historically, albeit regional trends often vary significantly.

Ratings Score Snapshot

Corporate Credit Rating

BBB-/Stable/--

Business risk: Satisfactory

- **Country risk:** Low
- **Industry risk:** High
- **Competitive position:** Excellent

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bbb

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Negative (-1 notch)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria And Research

- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, April 7, 2017
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Transportation Cyclical Industry, Feb. 12, 2014
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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