TEXT-Fitch affirms National Express at 'BBB-', outlook stable

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June 22 - Fitch Ratings has affirmed National Express Group Plc's (NEX) Long-term Issuer Default Rating (IDR) and Senior Unsecured ratings at 'BBB-'. The Outlook for the Long-term IDR remains Stable.

NEX's ratings reflect its leading position in the UK coach segment and in the Spanish coach and bus sector. Additionally, NEX's earnings are more diversified compared to some of its peers with it also benefitting from some visibility in its contracted US school bus business. Although the current environment in the US remains challenging, the recent Petermann acquisition will likely mitigate lower operating profit from UK rail (due to loss of East Anglia franchise).

However, the debt-funded acquisition and Fitch's revised expectations for NEX's trading add to the agency's higher forecast of NEX's adjusted leverage (net lease-adjusted debt to EBITDAR, using unrestricted cash only) for 2012-13 of around 3.0x (pro-forma) from 2.7x. Fitch forecasts average funds from operations (FFO) coverage at above 5.0x in the forecast period. Despite recent success in new franchise pre-qualification, NEX also faces uncertainty regarding its future in the UK rail business.

NEX has continued to show improvement in performance with revenue growing 5.3% to GBP2,238m in 2011 and EBITDA margins increasing to 14.8% from 14.3%.

UK Rail saw revenue increase by 8% as a result of increased passenger numbers. Despite earlier disappointment on the East Anglia franchise, NEX pre-qualified for Great Western and Essex Thameside services in March 2012. NEX's North American (NA) business showed good performance with operating profit margin increasing to 10% in 2011 through reduced overhead and back-office costs. Fitch anticipates limited further margin improvement.

Revenue growth in Alsa remained consistent throughout the year, mainly from intercity coach services and urban bus, but also supported by the new Agadir contract in Morocco. Trading within the UK bus and UK coach divisions has been resilient, with improved margins in both businesses through cost efficiencies. UK Bus saw the lowest YoY growth out of all segments with 2011 revenues increasing 2.3%; however, operating profits increased 15.5% despite passenger numbers falling 7% from 2010.

Fitch believes that conditions within NEX's UK bus and coach segments will remain stable, if challenging, while the agency would expect the group to continue focusing on cost control initiatives and better service planning to mitigate consequences of measures related to the UK government's budget cuts. Fitch also notes that NEX, similarly to peers, remains hedged to smooth out fuel price volatility.

After the debt-funded Petermann acquisition closed in May 2012, Fitch expects YE12 adjusted leverage to be reported above 3.0x and pro-forma adjusted leverage around that level. A sustained adjusted leverage above 3.0x, for example due to further debt-funded acquisitions, would be negative for the company's ratings. However, the agency anticipates NEX's adjusted leverage to gradually decrease despite Fitch's somewhat less robust earnings expectation for NEX. Non-rail free cash flow (FCF) is expected to be positive in the near-term supporting NEX's current ratings.

Liquidity remains adequate and is supported by an unrestricted cash balance of GBP78.5m at 31 December 2011 and available undrawn committed lines of GBP500m. This is sufficient to cover its current debt obligations of GBP54.8m out of total debt of GBP773.2m (GBP769.2m in 2010). The company has a healthy debt maturity profile with no major maturities until 2017 when its 7-year GBP350m bond comes due.

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