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Research Update:

The Federal Bridge Corp. Ltd. 'A-' Ratings Affirmed On Asset Diversity; Outlook Stable

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Overview

- We are affirming our 'A-' long-term issuer credit and senior unsecured debt ratings on The Federal Bridge Corp. Ltd. (FBCL).
- The ratings reflect the FBCL's stand-alone credit profile, which we assess at 'bbb', and a moderately high likelihood of support from the Government of Canada.
- In part, the ratings reflect our assessment of the corporation's relatively unfettered ability to raise tolls, diversity of assets (which help to mitigate traffic volatility and contributes to cash flow stability), and strong liquidity.
- The stable outlook reflects our expectation that, in the next two years, FBCL's overall traffic will remain relatively stable and its debt burden will continue to decline.

Rating Action

On Jan. 20, 2016, Standard & Poor's Ratings Services affirmed its 'A-' long-term issuer credit and senior unsecured debt ratings on The Federal Bridge Corp. Ltd. (FBCL), owner of the Canadian portion of four international bridges. The outlook is stable.

Rationale

The ratings reflect the FBCL's stand-alone credit profile (SACP), which Standard & Poor's assesses at 'bbb'. The ratings also reflect our opinion of a "moderately high" likelihood that the Canadian government would provide extraordinary support to the corporation in the event of financial distress, which results in a two-notch uplift to the ratings.

The SACP reflects Standard & Poor's view of the following credit strengths:

- The FBCL's relatively unfettered ability to set rates. Unlike other rated bridge authorities within Canada, such as the Halifax-Dartmouth Bridge Authority, under the Canada Transportation Act, the FBCL can increase toll rates and only needs to notify the federal Minister of Transport before the effective date. We believe the corporation benefits from upward pricing flexibility, because its tolls for its largest bridge (Blue Water Bridge [BWB]) on fully weighted commercial vehicles are low compared with those of competitors, such as the Ambassador Bridge in Windsor, Ont.;
- Strong management team following the amalgamation of Blue Water Bridge

Canada (BWBC) with FBCL, which we expect will implement better budget, capital, and asset management processes, resulting in cost efficiencies;
- A diverse portfolio of assets, which helps mitigate traffic volatility and contribute to cash flow stability through economic cycles. The FBCL's bridge system consists of the Canadian portion of four international bridges (the BWB, the Sault Ste. Marie International Bridge, the Thousand Islands International Bridge, and the Seaway International Bridge);
- Strong traffic demand profile and competitive advantages associated with the strategic location of the corporation's bridges within Ontario, which represents about 40% of Canada's economic output. More important, distribution of goods by truck remains the most significant delivery mode for 90%-95% of Ontario's exports to the U.S. market. The portfolio of bridges represents important crossing points to the U.S. for commercial vehicle traffic; together, they accounted for about 32% of truck crossings between Ontario, and Michigan and New York in 2014 and as of Sept. 30, 2015. We expect the FBCL's bridges to maintain a similar market share for trucks over the next two years;
- Relatively stable debt service coverage ratio (DSCR) in the next two years under our base-case scenario, with a fully amortizing DSCR remaining near 1.5x. We also expect the corporation's debt burden to decline, with debt to revenues falling to 2.3x by fiscal 2018 (year ended March 31) from 2.8x in fiscal 2015; and
- A relatively mature capital program in the next two years that will minimize the need for additional indebtedness and, therefore, will help contribute to a decline in FBCL's debt burden.

The SACP also reflects our view of the following credit weaknesses:
- Traffic demand for international border crossings is very sensitive to economic cycles, with changes in economic output affecting commercial traffic to and from the U.S. Moreover, both commercial and passenger traffic are also sensitive to changes in the Canadian dollar, but in contrasting ways. Commercial traffic typically benefits from a weaker Canadian dollar compared with the U.S. dollar, due to higher export activity. This is an important consideration, in our view, because commercial traffic accounts for more than 60% of the corporation's toll revenues. We predict that the FBCL's traffic growth will generally track Canada's economy in the medium term. In the next two years we expect traffic growth will remain relatively stable, reflecting the weakness in the Canadian economy. The corporation has a somewhat concentrated revenue stream, with its largest bridge, BWB, accounting for 46% of total traffic and toll revenues in fiscal 2015. Although cross-border travel declined significantly in the aftermath of the 2008-2009 recession -- mainly due to the volatile auto and manufacturing sectors -- traffic has recovered since 2010, returning to prerecession levels.
- The FBCL is subject to moderate competition from competing alternative bridges to the U.S., such as the Ambassador Bridge, although these competing facilities are at capacity therefore mitigates this somewhat.

In accordance with our criteria for rating government related entities (GREs), our view of the FBCL's moderately high level of extraordinary support reflects our assessment of the corporation's important role for Canada and its strong link with the federal government. In our view, the corporation's role reflects its arm's-length, mandate to operate the Canadian side of four international bridges, which are economically important to Ontario and, in turn, the federal government. In addition, our view of the link reflects the federal government's ownership of the FBCL and track record of providing strong credit support to the corporation, which has a clear corporate governance structure with independent management. The corporation has also received a guarantee on its assumed debt from Blue Water Bridge Authority. Although this does not meet our guarantee criteria in terms of timeliness, we believe it further supports the FBCL's strong link with the federal government.

Liquidity

In our view, the corporation's rate-setting autonomy and available liquidity are important rating considerations, offering a sizable cushion to manage traffic fluctuations. As of fiscal 2015 year-end, FBCL had C$44.8 million in cash and investments and a C$5 million undrawn committed letter of credit. This represented about 1,041 days of cash on hand, which we consider strong. In the next year, we expect that liquidity will remain strong, exceeding 750 days of cash on hand.

Outlook

The stable outlook reflects our base-case forecast that in the next two years, we expect the FBCL's traffic to remain relatively stable and its debt burden to decline. In addition, should traffic decline on a sustained basis, we expect management to take steps, such as controlling costs or potentially raising toll rates, to mitigate the impact on the corporation's financial performance. A material and sustained rise in traffic volumes and a substantial improvement in DSCR above 2x in the next two years would be a precondition for a positive rating action. In addition, a strengthening of the link to very strong due to evidence of an increasing track record of support by the government could also result in a positive rating action. Conversely, unfavorable changes to FBCL's business risk profile, a sustained decline in its DSCR well below 1.3x, or a change in the link with the federal government (for instance due to privatization or negative government intervention) could lead us to lower the ratings.

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria: Toll Road And Bridge Revenue Bonds In The U.S. And Canada, Feb. 25, 2014

Ratings List

Ratings Affirmed

The Federal Bridge Corp. Ltd.	
Issuer credit rating	A-/Stable/--
Senior unsecured	A-

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