

KBRA Assigns Ratings to Buckeye Tobacco Settlement Financing Authority, Series 2007

NEW YORK (January 28, 2020) – Kroll Bond Rating Agency (KBRA) assigns ratings to ten classes of Tobacco Settlement Asset-Backed Bonds, Series 2007 (the “Bonds”) issued by Buckeye Tobacco Settlement Financing Authority (the “Authority”).

Buckeye Tobacco Settlement Financing Authority, Series 2007				
Class	Outstanding Amount*	Interest Rate**	Final Maturity Date	KBRA Rating
2007A-2 Senior Current Interest Turbo Term Bonds	\$167,535,000	5.375%	6/1/2024	CCC+ (sf)
2007A-2 Senior Current Interest Turbo Term Bonds	\$795,295,000	5.125%	6/1/2024	CCC+ (sf)
2007A-2 Senior Current Interest Turbo Term Bonds	\$687,600,000	5.875%	6/1/2030	CCC+ (sf)
2007A-2 Senior Current Interest Turbo Term Bonds	\$505,200,000	5.750%	6/1/2034	CCC+ (sf)
2007A-2 Senior Current Interest Turbo Term Bonds	\$250,000,000	6.000%	6/1/2042	CCC+ (sf)
2007A-2 Senior Current Interest Turbo Term Bonds	\$750,000,000	6.500%	6/1/2047	CCC+ (sf)
2007A-2 Senior Current Interest Turbo Term Bonds	\$1,383,715,000	5.875%	6/1/2047	CCC+ (sf)
2007A-3 Senior Convertible Capital Appreciation Turbo Term Bonds	\$375,800,000	6.250%	6/1/2037	CCC+ (sf)
2007B First Subordinate Capital Appreciation Turbo Term Bonds	\$3,207,000,000	7.250%	6/1/2047	CCC (sf)
2007C Second Subordinate Capital Appreciation Turbo Term Bonds	\$3,417,300,000	7.500%	6/1/2052	CCC (sf)

* Accreted value at maturity for 2007B and 2007C.

** Approximate yield to maturity for 2007B and 2007C.

KBRA has analyzed this transaction using the [Global General Rating Methodology for Asset-Backed Securities](#) published on November 28, 2017, the [Global Structured Finance Counterparty Methodology](#) published on August 8, 2018 and the [Corporates: General Corporate Global Rating Methodology](#), published on November 28, 2017.

Transaction Summary

The Bonds were originally issued in 2007 and consisted of three senior classes (A-1, A-2, and A-3) and two subordinate classes (B and C). The Class A-1 notes have been fully repaid. The Class A-3 notes were issued as convertible capital appreciation bonds but they reached their conversion date on December 1, 2012 so they have now converted to current interest bonds. The subordinated classes are capital appreciation bonds and capitalize interest until their respective maturity dates in 2047 and 2052.

Collateral for the Bonds includes 100% of tobacco settlement payments that are required to be made by tobacco manufacturers to the State of Ohio under the 1998 Tobacco Master Settlement Agreement (MSA). The senior bonds also benefit from a reserve account.

In November 1998, the MSA was entered into between 46 US states, the District of Columbia, several US territories and the then four largest US tobacco manufacturers, known as the original participating manufacturers ("OPMs"). Numerous smaller tobacco manufacturers joined the MSA after the OPMs, and are referred to as subsequent participating manufacturers ("SPMs"). There are tobacco manufacturers that did not become parties to the MSA, and such firms are known as the Non-Participating Manufacturers ("NPMs"). The MSA resolved cigarette smoking-related litigation among the settlement states and the participating manufacturers, consisting of both the OPMs and the SPMs (collectively, the "PMs"), and provides those states with annual tobacco settlement payments from the PMs in perpetuity. After the MSA was signed, many states and local governments securitized some or all of their rights to receive future settlement payments.

Under the MSA, payments to the states are subject to various adjustments, including the inflation adjustment, volume adjustment, and NPM adjustment. The inflation adjustment increases the base amounts of the MSA payments, based on the higher of the percentage increase in the Consumer Price Index for All Urban Consumers and 3%. The volume adjustment increases or decreases the MSA payments by an amount that accounts for fluctuations in the number of cigarettes shipped by the OPMs in or to the United States. The NPM adjustment may reduce the payments of the PMs under the MSA in the event of losses in market share by the PMs to NPMs as a result of such PMs' participation in the MSA.

Under the MSA, three conditions must be met in order to trigger an NPM adjustment: 1) a market share loss was experienced for the applicable year; 2) a nationally recognized firm of economic consultants determines that the disadvantages experienced as a result of provisions of the MSA were a significant factor contributing to the market share loss for the applicable year; and 3) the settling state in question are found to not have diligently enforced their qualifying statutes. The PMs have disputed MSA payments related to sales years dating back to 2003. In December 2012, terms of a settlement agreement were agreed to by a number of US states and territories, the OPMs and certain SPMs regarding claims related to the 2003 – 2012 NPM adjustments and determination of subsequent NPM adjustment. However, the State of Ohio is not party to the settlement term sheet.

Key Credit Considerations

KBRA considered several key factors in its analysis of this transaction, including:

- The credit quality of the large PMs, which has strengthened in recent years. Recent declines in tobacco consumption and the risk of further declines: after increasing about 2% in 2015, tobacco consumption declined by about 4%-5% in 2016-2018. More recent cigarette consumption declines are partially attributable to increased e-cigarette usage. Other factors can also contribute to decreased tobacco consumption including increased taxation or regulation and decreased discretionary income.
- The potential for litigation that may have a material impact on the PMs or the MSA.
- The pro-rata payment structure following payment default. Two of the class A-2 notes have maturity dates in 2024. If principal is not paid in full on the maturity date, a payment default will occur and all collections will begin to be paid pro rata to all of the outstanding senior classes. This will slow the repayment of principal for all classes and lead to future missed principal payments for future maturity dates.
- The transaction's legal structure.
- Cash flow analysis: the table below shows the base case assumptions for the key inputs to the cash flow analysis. Under the base case scenario, timely interest is paid up until the first legal final maturity date for the Class A-2 notes in 2024. In this period, MSA payments and the Senior Liquidity Reserve Account are not sufficient to fully repay principal on the two

maturing notes. Therefore, the payment priority switches to pro rata from sequential and all funds each payment date are used to make pro rata payments to all senior notes. The Class 2007B and 2007C notes do not receive any payments under the base case scenario.

Base Case Scenario	
Consumption Decline	
Years 1 - 10	3.75 - 4.25%
Years 11 - 20	4.25 - 4.75%
Years 21 - 30	4.75 - 5.25%
Thereafter	5.25 - 5.75%
Market Share	
OPM	83 - 85%
SPM	7 - 10%
NPM	7 - 10%
NPM Adjustment	
Amount Withheld	13 - 15%
Time Lag for Withholding Recovery	15 - 20 Years
Recovered Amount	90 - 100%
Inflation Rate	3.0%

Rating Sensitivity and Surveillance

The primary factor that could lead to changes in the ratings is cigarette consumption. If cigarette consumption materially increases, MSA payments would be higher which could lead to ratings upgrades. Alternatively, if cigarette consumption declines more than the base case assumptions, MSA payments would be lower and this could lead to downgrades. KBRA will monitor consumption rate changes as well as the remaining time to legal final maturity of each class of notes.

To access ratings, reports and disclosures, click [here](#).

Related Publications: (available at www.kbra.com)

- [Global General Rating Methodology for Asset-Backed Securities](#)
- [Global Structured Finance Counterparty Methodology](#)
- [Representations and Warranties Disclosure](#)

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