INFRAX CVBA (/gws/en/esp/issr/94604290)

FitchRatings

Fitch Maintains Infrax's 'A' on Rating Watch Negative

Fitch Ratings-Warsaw/London-19 March 2018: Fitch Ratings has maintained Infrax Cvba's Long-Term Issuer Default Rating (IDR) and senior unsecured rating of 'A' on Rating Watch Negative (RWN).

We placed Infrax on RWN on 30 October 2017, due to its plans to merge with Eandis System Operator (Eandis) under the name Fluvius. We have maintained Infrax on RWN due to Fluvius's expected leverage being higher than that of Infrax, resulting in a possibly lower credit profile, and the risk that Infrax's bondholders will not be ring-fenced from the more leveraged Eandis-part of the future Fluvius after the merger and planned substitution of the issuer from Infrax to Fluvius.

Fitch assumes that the merger between Infrax and Eandis will take place. Consequently, Fluvius will become Infrax's legal and business successor while Infrax will cease to exist as a separate company and become part of Fluvius on completion of the merger. We expect completion of the merger in 2H18.

KEY RATING DRIVERS
Infrax Improving Standalone Profile: Infrax has been improving its credit metrics and we forecast that the company's funds from operations (FFO) adjusted net leverage for 2017 was about 3.5x (compared with a peak of 4.7x in 2015). This was in line with our positive rating guideline for the company before 30 October 2017. Deleveraging was possible thanks to positive regulatory developments in Flanders, including effective elimination of the tariff deficits, gradual recuperation of past tariff deficits as well as sale of the accumulated stocks of green and cogeneration power certificates successfully completed in 2017.

Merger with Eandis: We assume that Infrax will merge with Eandis as both companies are already advanced in the process and that the merger will be finalised in 2H18. Eandis's operations are near 100% regulated networks. The company has a similar corporate structure to that of Infrax and conducts operations in Flanders. Eandis is the operator of electricity and gas networks and, like Infrax, its debt is guaranteed by its DSO (distribution system operators) shareholders. Eandis is about 3x larger in terms of FFO than Infrax. However, Eandis has also higher FFO adjusted net leverage, which based on its 2016 results we estimate at around 7x.

High Leverage at Fluvius: Due to the higher leverage of Eandis than Infrax and Eandis's larger share in the combined entity, Fluvius will have higher leverage than Infrax. We estimate that a combined Infrax and Eandis entity would have FFO adjusted net leverage of about 6x for 2017. We see some potential for reduction of the leverage in the following years thanks to the ongoing supportive regulatory framework in Flanders, which has facilitated the improvement in Infrax's results over the past three years. However, the long-term plan for Fluvius is not available at this stage; so Fluvius could theoretically accept having higher leverage on a constant basis.

Likely Stronger Business Profile at Fluvius: Fluvius's business profile will be likely stronger than that of Infrax due to the larger scale of operations and also improved diversification. In our view, the likely significant synergies will mostly be transferred back to Flemish citizens in the form of lower tariffs.

Better Financial Transparency: The merger may lead to improved financial transparency if Fluvius prepares consolidated financial statements under IFRS and including segmental reporting. Reporting in line with its western European peers could lead to the elimination of the notch down to Infrax's IDR which we currently apply due to complexity of the group structure, lack of consolidated statements and the cash flow statement, and governance limitations.

Downside Risk for the IDR: Considerably higher FFO adjusted net leverage at Fluvius vs. that of Infrax (about 6x for Fluvius vs. about 3.5x for Infrax based on our pro-forma estimates for 2017, with negative rating guideline of 4.5x for the current rating) results in negative rating pressure on Infrax's IDR, as reflected in the RWN. This is mitigated by our expectation of improved financial transparency at Fluvius and also an improved business profile. Consequently, if we downgrade Infrax's IDR upon resolving the RWN, we currently expect the potential downgrade to be limited to one notch.

Links with Parent: Infrax's 'A' IDR benefits from a one-notch uplift from its standalone credit profile of 'A-' for support from the region, the Flemish Community. We analyse the support under Fitch Government-Related Entities Criteria. We view the status, ownership and control links between Infrax and the Flemish Community as strong, as are the support track record and expectations. We deem the socio-political implications of Infrax's potential default as moderate. Services like electricity and gas supply and sewage collection are essential for local communities, but for the same reason default on Infrax's debt should not lead to persistent disruption of the company's services. The financial implications of Infrax's potential default are weak due to relatively small size of the company when compared with the Flemish Community (hence likely not impacting e.g. the region's costs of financing). We anticipate that the one-notch uplift will remain in place also after the merger with Eandis.

Senior Unsecured Rating: We currently expect that the senior unsecured rating will remain linked to the IDR. Consequently, if Infrax's IDR is downgraded by one notch, the senior unsecured rating would also be downgraded by one notch. This risk is reflected in maintaining the senior unsecured rating on RWN.

We understand from Infrax that after the considered substitution of the issuer of Infrax's bonds to Fluvius (to be approved by Infrax's bondholders), bonds issued originally by Infrax will remain guaranteed by the same, Infrax-side guarantors. This could lead us to link the senior unsecured rating for bonds issued originally by Infrax to the credit profile of its guarantors. Consequently, the senior unsecured rating could remain unchanged if FFO adjusted net leverage of Infrax-part of future Fluvius stays considerably lower than that of the Eandis part.

This approach would be conditional on keeping separate activities, settlements, bank accounts and reporting at Fluvius level for bonds guaranteed by ex-Infrax and ex-Eandis. It should allow us to clearly cut off part of the Fluvius business guaranteed by Infrax and Eandis. We note that if there are mergers between the guarantors of Infrax's and Eandis' debt on a large scale (one of examples is the already planned merger between IVEG, IMEA and INTEGAN), the separation of the two guarantor groups would not be evident. This is because the merged guarantors will then guarantee their share of the debt at both Infrax and Eandis.

DERIVATION SUMMARY
Infrax has a comparable business profile with other network-focused multi-utility companies rated by Fitch such as Acea SpA (BBB+/Stable) and Iren SpA (BBB/Stable), but also to pure DSOs like Italgas SpA (BBB+/Stable) and Madrilena Red de Gas SAU (BBB-/Stable). Relative to peers, Infrax is virtually fully concentrated on network activities and its projected leverage is lower. The credit constraints for Infrax are the complex group structure and the lack of a joint debt guarantee to Infrax by all affiliated DSOs. The latter is mitigated by the overall comparable profiles of the individual DSOs as well as by the tight integration within the Infrax group.

KEY ASSUMPTIONS
Fitch's key assumptions within our rating case for the issuer include:
- Merger with Eandis taking place in 2H18;
- Consent of Infrax bondholders to change the EMTN documentation in a way allowing merger with Eandis;
- Capacity of Infrax DSOs to service debt not affected by the merger;
- A stable business profile for Infrax in all business areas.

RATING SENSITIVITIES
Due to the RWN positive rating action is unlikely. However, the following developments could lead to resolving the RWN with an affirmation:
- More clarity on the credit quality of Fluvius, in particular preparation of a long-term financial plan for Fluvius and stating leverage targets;
- Merger accomplished with the bondholders consent and unchanged guarantor structure; provisions in the revised bond documentation ring-fencing risks for EMTN bondholders from the Eandis side.

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Fluvius having lower credit quality than Infrax. Negative rating sensitivity for Infrax is FFO adjusted net leverage higher than 4.5x on a sustained basis. For Fluvius we consider a more relaxed leverage guideline (than applied to Infrax) given the stronger business profile and possibly improved financial transparency compared with Infrax;
- Continuation of the merger process without consent of the bondholders, if liquidity pressure appears.

LIQUIDITY
Adequate Liquidity, Possible Pressure: Infrax's current liquidity is adequate. As of year-end 2017 Infrax had EUR63 million of bank deposits and EUR200 million of undrawn short-term committed credit lines compared with debt due in the next 12 months of EUR72 million. The company also had a EUR200 million uncommitted CP programme available at this date.

However, the planned merger puts some risks on the liquidity side if the bondholders do not agree to the merger, but despite this Infrax pursues with the merger. In such a case refinancing of the EMTN programme could be necessary.

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Summary of Financial Statement Adjustments - Fitch treated financial income from the lease contract with Telenet as operating income

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Criteria (pub. 07 Aug 2017) (https://www.fitchratings.com/site/re/901296)
Exposure Draft: Corporate Rating Criteria (pub. 14 Dec 2017) (https://www.fitchratings.com/site/re/907387)
Exposure Draft: Sector Navigators (pub. 21 Dec 2017) (https://www.fitchratings.com/site/re/914221)
Government-Related Entities Rating Criteria (pub. 07 Feb 2018) (https://www.fitchratings.com/site/re/10019302)
Non-Financial Corporates Notching and Recovery Ratings Criteria (pub. 21 Dec 2017) (https://www.fitchratings.com/site/re/914144)

Additional Disclosures
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