

Rating Action: Moody's changes Fluvius's outlook to stable, affirms A3 ratings

25 Jul 2019

Paris, July 25, 2019 -- Moody's Investors Service ("Moody's") has today affirmed Fluvius System Operator CVBA's ("Fluvius") A3 backed long-term issuer rating and backed senior unsecured ratings and changed the outlook to stable from positive.

A full list of affected ratings is provided towards the end of this press release.

RATINGS RATIONALE

RATIONALE FOR CHANGING OUTLOOK TO STABLE FROM POSITIVE

The outlook change reflects Moody's expectation that the cash-flow-based metrics for the Fluvius Economic Group will revert to a level commensurate with the guidance for the current rating as a result of the decrease in tariffs implemented by the regulator until the end of the current regulatory period to 2020, combined with the material step-up in capital expenditure from 2019 and the relatively high dividend.

The regulator's decision to cut tariffs reflects the lower cost allowance than the actual costs incurred between 2010 and 2014. While Fluvius had been allowed to recover those costs through the tariff evenly between 2016 and 2020, this decision means that it will not recover as much as expected in 2019 and 2020. This together with the fact that Fluvius will now no longer benefit from the tariff surcharge for the recovery of costs incurred between 2010 and 2015 for green and cogeneration certificates, will mean Fluvius will earn lower cash flow than Moody's had anticipated. Furthermore, the increase in investment requirements to support energy transition, including smart metering, as well as the high level of dividend payments will lead to an increase in net debt which will result in metrics reverting to those appropriate for the current rating.

Nevertheless, following the merger of Eandis System Operator CVBA with the lower-g geared Infrac System Operator CVBA in July 2018 to create Fluvius, Fluvius has significantly lower balance sheet leverage than its predecessor, as measured by Net Debt / Fixed Assets, which is projected to average 61% in 2019 and 2020 compared to 69.4% in 2017 and 77.6% in 2016.

The future direction of Fluvius's rating will depend on the outcome of the next regulatory settlement for the period 2021 to 2024. There will be greater visibility of this throughout the later part of 2020 as the regulatory proposals are finalized. Fluvius's projected credit metrics for that period will reflect the allowed return, which may be lower than the current period given the continued low market interest rates in Europe, and the cost allowances and operational targets permitted by the regulator in the context of the recent merger.

RATIONALE FOR RATING AFFIRMATION

Fluvius's A3 ratings continue to reflect the robust credit quality of the distribution system operators (DSOs) which currently own the company and severally guarantee its liabilities. This is underpinned by the low business risk profile of their regulated electricity and gas distribution network operations in Flanders, Belgium. The regulatory framework is supportive and transparent, albeit relatively new and untested in the context of European regulated network peers following the transition of tariff-setting responsibilities from the national to the regional regulators in 2014.

Following the merger of Eandis and Infrac, ex-Eandis bonds continue to be guaranteed by its original owners, the DSOs Gaselwest, Imewo, Intergem, Iveka, Iverlek, Sibelgas and Fluvius Antwerpen (the later a result of the merger of IMEA, Integan and Iveg).

Fluvius's A3 rating incorporates a two-notch uplift for potential state support from its standalone credit quality (baseline credit assessment) of baa2. This is based on Moody's assessment of high dependence between Fluvius and its owners, all 300 municipalities within the Community of Flanders (Aa2 stable), and a strong likelihood of Fluvius receiving support in the event this were needed to avoid a debt payment default.

RATING OUTLOOK

The outlook is stable, reflecting Moody's expectation that financial metrics will remain commensurate with the guidance for the current rating, i.e., net debt / fixed assets below the high 70s in percentage terms and funds from operations (FFO) / net debt above 10%.

WHAT COULD CHANGE THE RATING UP/DOWN

The rating could be upgraded if leverage calculated as net debt / fixed assets appears likely to remain comfortably below 70% and FFO / net debt is at least in the low teens in percentage terms, on a sustainable basis.

Conversely, Moody's could downgrade the rating if the financial metrics of the Economic Group Fluvius weakened such that consolidated net debt / fixed assets was likely to be persistently above 80%, and FFO / net debt was below the high single-digits in percentage terms. The ratings may also come under downward pressure if Moody's assessed a lower probability of support from the Community of Flanders or if the rating of the sub-sovereign was downgraded.

Fluvius System Operator CVBA (ex Eandis System Operator CVBA) is a Belgian utility established in March 2006, which provides the regulated activities of operating the electricity and gas distribution networks in the Community of Flanders, Belgium. Fluvius was formed through the merger of Eandis and Infrax CVBA in July 2018 and is 100% owned by the municipalities of the Community of Flanders. Fluvius, together with its eleven DSO shareholders form the Fluvius Economic Group which derives around 90% of its operating profit from the regulated energy distribution activities, with the remaining 10% derived predominantly from regulated sewerage and contract-based CATV network operations. The group also holds small district heating infrastructure in selected areas.

LIST OF AFFECTED RATINGS

Affirmations:

..Issuer: Fluvius System Operator CVBA

...Backed LT Issuer Rating, Affirmed A3

...Backed Senior Unsecured MTN Program, Affirmed (P)A3

...Backed Senior Unsecured Regular Bond/Debenture, Affirmed A3

Outlook Actions:

..Issuer: Fluvius System Operator CVBA

...Outlook, Changed To Stable From Positive

The methodologies used in these ratings were Regulated Electric and Gas Networks published in March 2017, and Government-Related Issuers published in June 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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