

Rating object		Rating information	
Eandis System Operator cvba (Group)		Rating: A+	Outlook: stable
Creditreform ID:	2000000588	Prepared on:	January 18, 2017
Incorporation:	March 30, 2006	Monitoring period until:	January 17, 2018
(Main) Industry:	Operating company of seven Distribution system operators (DSOs)	Date of release:	January 19, 2017
Management:	Walter Van den Bossche, CEO	Rating methodology:	Corporate ratings
		Rating history:	www.creditreform-rating.de

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Abstract

Company

Eandis System Operator cvba (*Elektriciteit, Aardgas, Netten en Distributie* - ESO) and its three consolidated subsidiaries are the operating company of seven distribution system operators¹ (DSOs) active in Flanders, Belgium. The company was established in 2006 and is responsible for the distribution of the electricity and gas to private households and SMEs (low or medium voltage/pressure). ESO, its three consolidated subsidiaries and the seven DSOs constitute together the Eandis Economic Group (the EEG – the Group) that owns 97,312 of km electricity cables (2.6 million electricity connections) and 42,598 km of gas pipes (1.7 million gas connections) in a territory comprising 4 Walloon and 229 Flemish cities and municipalities. As ESO operates on a cost price basis on behalf of the seven DSOs and given that the seven DSOs provide guarantee for all debt obligations incurred by ESO, it seemed fair to us to consider the EEG as a whole in order to assess the creditworthiness of ESO.

The EEG employed about 4,480 people on average in 2015 and is by far the largest DSO group in Belgium. Following the new tariff methodology implemented by the *Vlaamse Reguleringsinstantie voor de Elektriciteits- en Gasmarkt* (VREG) for the period 2015-2016, i.e. revenue cap instead of cost plus method, the group achieved consolidated revenues of EUR 2,618.6 million in 2015 (previous year: EUR 2,694.96 million) and a net profit of EUR 332.5 million (2014: net loss of EUR -128.8 million). EBIT grew by 22.7% at EUR 612.1 million in 2015.

Rating Result

The current rating attests a good credit rating (creditworthiness) to ESO, representing a low insolvency risk for the company in comparison with the sector and the overall economy. The EEG has strategic importance for the region and disposes of a supportive regulatory framework in Flanders. We therefore assume that its public shareholders would support the EEG if needed. Any change in the sovereign rating of Belgium or of Flanders could therefore have an impact on Eandis corporate rating. The credit risk position of the Group could deteriorate if the financial needs of the company rise, considering that the Group already has a high gearing. The overall lower returns, expected in the regulatory period 2017-2020, have a dampening effect on the rating.

Outlook

The yearlong outlook of the rating is stable. This appraisal takes into account the low business risk profile of the company and the moderate financial risk profile of the Group even with the further

¹ Gaselwest, IMEA, Intergem, Imewo, Iveka, Iverlek and Sibelgas.

increase of the Group's debt level given the guarantee of the DSOs and the assumed support of its shareholders in case of distress.

Relevant rating factors

Financial ratios' extract Basis: consolidated annual statement per 31.12 (IFRS)	Standardized annual financial statement (Eandis Economic Group)	
	2014	2015
Total assets	EUR 10,160.83 m	EUR 9,723.19 m
Revenues	EUR 2,694.96 m	EUR 2,618.65 m
EBITDA	EUR 796.50 m	EUR 945.34 m
EBIT	EUR 481.28 m	EUR 612.07 m
Total comprehensive income for the period	EUR -128.82 m	EUR 332.52 m
Equity ratio	28.75%	23.78%
Return on investments	1.22%	5.32%
Operating profit margin	78.56%	68.78%
Net Financial Debt / EBITDA	9.08	7.84
Interest expenses / debt	3.56%	2.86%
Short term capital commitment ratio	32.07%	52.55%

General rating factors

- + Strategic importance of the company for the region - crucial market player in the energy distribution in Flanders
- + Transparent and supportive regulatory framework with guaranteed revenues and predictable cash flows
- + Natural regional monopoly for gas and electricity
- + Probable and assumed support of the regional authorities (shareholders) if necessary
- + Low business risk profile of the DSOs
- + Guarantee of the DSOs for debts taken by ESO (in proportion of their capital share in ESO)

- Ongoing investments required
- Capital intensive business, high fixed costs

Current factors (rating 2017)

- + Higher EBIT and positive net profit in 2015
- + Increased revenues thanks to new tariff methodology for the regulatory period 2015-2016

- High gearing and net debt / EBITDA ratio
- Low investments for the past 5 years
- Current negative balance between budgeted and realized income and expenses
- Relatively high pay-out ratio
- Subject to corporate income tax from 2015 onwards

Prospective rating factors

- + Investments in the infrastructure
- + Allowed recovery of regulatory assets/liabilities 2010-2014 over a 5-year period until 2020

- Lower allowed return during the next regulatory period 2017-2020 than in 2015-2016
- Commitment of stable dividend payments until 2019 with a relatively high pay-out ratio
- Possible deterioration of the credit risk position following further indebtedness linked to necessary investments and debt refinancing

Business development and outlook

During the year 2015, the Eandis Economic Group achieved revenues amounting to EUR 2,316 million (2014: EUR 2,014 million), among which 94.2% were generated by remuneration for the distribution and transport of electricity and gas, 3.1% by the direct sale of energy to households that have problems finding an energy provider (public service obligation), and 2.6% by construction work for other parties. The volume of electricity transported in 2015 was similar to the volume of 2014. Gas volumes increased but are strongly related to outside temperatures. The volume of electricity transported was nevertheless 2.5% lower than the average over 5 years and the gas volume was 9.0% lower than the average over 5 years. When considering only the revenues from the distribution and transport of electricity and gas, these increased by 8.4% due to the new tariff methodology of the Flemish regulator VREG, applied for the regulatory period 2015-2016. When the actual income and expenses do not fit the budgeted income and expenses, the balance needs to be recovered through tariffs in a subsequent period. The current assets/liabilities unbalance of EUR -205.9 million will be recovered within the next five years.

The investment level was in a downwards trend over the past five years (minus 28.6%) but the group expects to invest EUR 3.0 billion in the period between 2016 and 2020 for both the investments in infrastructure and the refinancing of its debts. The investment program 2015-2018 requires between 500 and 650 million EUR every year, incl. repayments and interest payments under current debts and incl. proceeds from the sale of green power and cogeneration certificates.

After the exit of Electrabel from the share capital of the DSOs in 2014, the Group planned a merger of the seven DSOs into a single DSO (Eandis Assets) in 2016 in order to simplify the structure and to enable the entry of a new external partner into the share capital of the group. This operation has nevertheless been aborted. The seven DSOs will continue to operate as separate entities and the equity could not be strengthened.

In the first half year of 2016, revenues increased by 9.2% to EUR 1,249.7 million in comparison with H1-2015, reflecting again the increased tariffs decided by the VREG. The cost of trade goods increased disproportionately based on the cost of green and cogeneration certificates as well as due to the cost of purchase for grid losses. The operating margin decreased to 20.4% (H1-2015: 22.7%). Due to an increase of EUR 23.0 million in financing costs, EAT for the period decreased by 20.5% and amounted to EUR 118.5 million. Equity rose thanks to the reported profit for the period but the share capital decreased following the exit of a municipality and two provinces from the DSOs.

Overall, we see no core risks associated with the current organizational and share capital structure of the Group. We assess the company as having a low business risk profile as the company is system relevant and currently benefits from a supportive regulatory framework from the VREG, generating predictable cash flows. We assess the financial risks of EEG as moderate and lower than in other industries. The Group disposes of a favorable business model with regulated tariffs, stability of earnings and low probability of a negative result. We furthermore assume that the Group will be able to count on the support of its public shareholders in the event of liquidity problems. Nevertheless, the expected lower allowed returns in the next regulatory period 2017-2020 as well as the further debt burden have a dampening effect on the rating. The EEG has the necessary financial instruments and capital market access to finance its investment plan, but its credit risk position may deteriorate following the expected bond issues (investments and bond refinancing). A significant increase of the net debt / EBITDA ratio could have a negative impact on the rating outlook and / or on the rating in a long-term perspective.

Annex

Regulatory requirements

After having prepared an unsolicited rating of the company on November 2016, the management of Eandis System Operator cvba has commissioned Creditreform Rating AG with the preparation of the rating (solicited rating) on December 7, 2016.

The rating is based on qualitative and quantitative analysis of relevant factors as well as on an estimation of the sector-specific influencing factors. The quantitative analysis is primarily based on the annual report for 2015, intermediate reports and press releases of the company as well as complementing information provided by Eandis.

The rating was prepared by analysts Marie Watelet (lead analyst) and Rudger van Mook (co-analyst).

The information and documents meet the requirements and are in accordance with the published Creditreform Rating AG's rating methodology. An electronic version of our rating methodology can be found on our website www.creditreform-rating.de.

A Rating Committee of highly qualified analysts of Creditreform Rating AG was called on January 18, 2017. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant risk factors, the Rating Committee arrived at a unanimous rating decision.

The rating result and the present rating report have been communicated to Eandis on the same day. A rating summary and a rating certificate have also been provided to the company.

The rating will be monitored for the duration of one year within which rating updates may occur. After the expiration of this term, a follow-up rating will be needed so that the rating remains valid.

A complete description of the rating methodology of Creditreform Rating AG is available on our website www.creditreform-rating.de.

In 2011 Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG (CRAG) is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

Conflict of Interests

No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks.

In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

Rules on the Presentation of Credit Ratings and Rating Outlooks

The approval of credit ratings and rating outlooks follows our internal policies and procedures. In line with our policy "Rating Committee," all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

To prepare this credit rating, CRAG has used following substantially material sources:

1. Annual Report
2. Website
3. Internet research.

There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. Furthermore CRAG considers satisfactory the quality and extent of information available on the rated entity. In regard to the rated entity Creditreform Rating AG regarded available historical data as sufficient.

Between the disclosure of the credit rating to the rated entity and the public disclosure no amendments were made to the credit rating.

The "Basic data" information card indicates the principal methodology or version of methodology that was used in determining the rating, with a reference to its comprehensive description.

In case where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the credit rating and indicates how the different methodologies or these other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

The meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions, such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings as well as best-case scenario credit ratings are explained.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the "Basic data" card as a "Rating action"; first release is indicated as "initial rating", other updates are indicated as an "update", "upgrade or downgrade", "not rated", "confirmed", "selective default" or "default".

In the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within „Basic data“ information card.

In accordance to Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available at the ESMA website: <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>.

An explanatory statement of the meaning of Creditreform`s default rates are available in the credit rating methodologies disclosed on the website.

Please note:

The present summary was delivered to Eandis with a comprehensive rating report as well as with a rating certificate. This report contains extensive information about the corporate rating of Eandis. In case of discrepancies between the summary and the report, the report shall prevail.

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Any rating performed by Creditreform Rating AG is subject to the “Verhaltenskodex der Creditreform Rating AG” (“The Creditreform Rating AG Code of Conduct”) which has been published on the web pages of Creditreform Rating AG. In this Code of Conduct, Creditreform Rating AG commits itself to – systematically and with due diligence – establishing its independent and objective opinion about the sustainability, the risks and the opportunities of the company / the issue under review.

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