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ISSUER COMMENT
3 June 2016

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RATINGS

Eandis System Operator CVBA

Outlook	Negative
Backed Issuer Rating	A1
Backed Senior Unsecured	A1

Source: Moody's

KEY METRICS:

Economic Group Eandis

	31 Dec 2015	31 Dec 2014	31 Dec 2013
FFO Interest Cover	3.0x	3.6x	4.0x
Net Debt/ Fixed Assets	80.5%	80.5%	68.0%
FFO/Net Debt	6.7%	8.3%	11.2%
RCF/Net Debt	3.7%	5.3%	6.8%

Source: Moody's Financial Metrics TM

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Eandis System Operator CVBA

Potential equity injection credit positive

Selection of a preferred bidder for a 14% stake in Eandis Assets, the parent of Eandis System Operator CVBA (Eandis, A1 negative) is credit positive. Subject to successful execution, proceeds from the planned sale of new shares in the Belgian utility will reduce debt and boost financial metrics.

On 1 June 2016, Eandis announced that it had entered into exclusive negotiations with State Grid International Development Limited (SGID, Aa3 negative), a wholly-owned subsidiary of State Grid Corporation of China (Aa3 negative) and responsible for its international utility investments, for it to take a 14% equity stake in Eandis Assets.

As at 31 December 2015, financial leverage of the Eandis economic group, comprising Eandis and its parent and measured by net debt to regulated asset base (RAB), was around 80% while the ratio of funds from operations (FFO) to net debt was below 10%. Proceeds from the sale will alleviate financial pressure and, subject to quantum, may restore metrics to within Moody's guidance for the current A1 rating, i.e. no more than 70% net debt/regulated assets and FFO/net debt at least in the low teens.

Subject to successful conclusion of the negotiations and necessary board and shareholder approvals, the transaction will likely close by the end of this year. We also note that an additional net equity contribution of around €60 million will be received from the intermunicipal financing associations by the end of June 2016. Municipal shareholders had already contributed around €100 million of additional equity during 2015.

Exhibit 1
Assuming the proposed transaction goes ahead as planned...

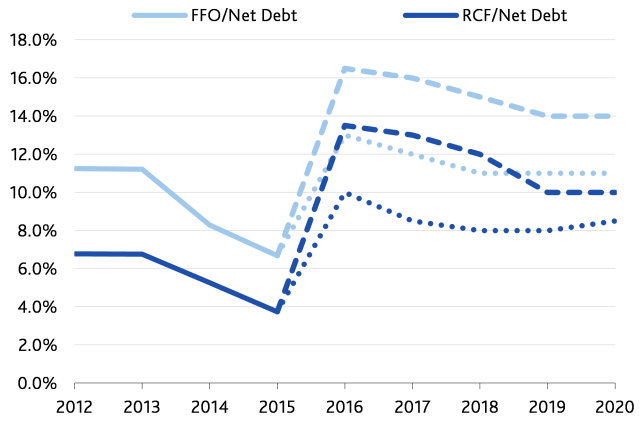
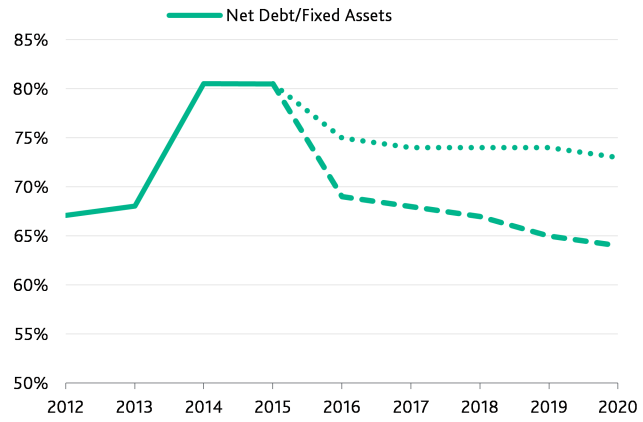


Exhibit 2
... Eandis's financial metrics will improve significantly



Note: Reflecting Moody's forecast on recovery of regulatory receivables and estimate of potential equity contributions.
Source: Moody's

The expected improvement in metrics will provide Eandis with some flexibility to accommodate pressures from a more challenging regulatory settlement as well as uncertain recovery of outstanding regulatory receivables.

In May 2016, the Flemish regulator for energy networks, VREG, announced its draft proposals for the next regulatory period 2017-20. The regulator's proposals include a cut in the allowed return to 5.0% (nominal, pre-tax) from 6.1% currently, reflecting the low interest-rate environment. More positively, VREG proposed more timely in-period adjustments for volume fluctuations and development of non-controllable cost items. In that context, Eandis will also be able to recover the previous tariff deficits of around €450 million, accumulated over the period 2010-14, over the five years 2016-20, albeit at a slightly slower pace than the company had envisaged.

Aside from the regulatory tariff deficits, Eandis reported €627 million outstanding receivables at the end of 2015, linked to its obligation to buy renewable energy certificates on behalf of suppliers. While costs of purchasing certificates are recoverable, the company has not been able to sell adequate numbers in the market. The Flemish government is deciding on a solution that would allow affected network companies to recover outstanding receivables over the five years 2017-21. However, while a customer levy has been introduced on supply charges, the exact recovery mechanism remains vague.

Eandis's A1 rating reflects Moody's assessment of the credit quality of the distribution system operator (DSO) Eandis Assets, which owns the company and guarantees its debt obligations. The stand-alone credit quality or Baseline Credit Assessment (BCA) of the Eandis economic group is in the high-Baa range. This assessment is underpinned by the low business risk profile of Eandis's regulated electricity and gas distribution network operations in the Flemish region. 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.

Finally, the assigned A1 rating also reflects around three notches of uplift from the BCA, considering the high probability that the Community of Flanders (Aa2 stable) will ultimately support the DSO should that become necessary in exceptional circumstances, given the strategic and economic importance of the provided services for the region.

The current negative outlook reflects the weakened credit quality of the Eandis economic group as a result of the debt raised to fund the exit of Electrabel and the risk that this may not be sufficiently offset by equity injections or other balance sheet strengthening. It

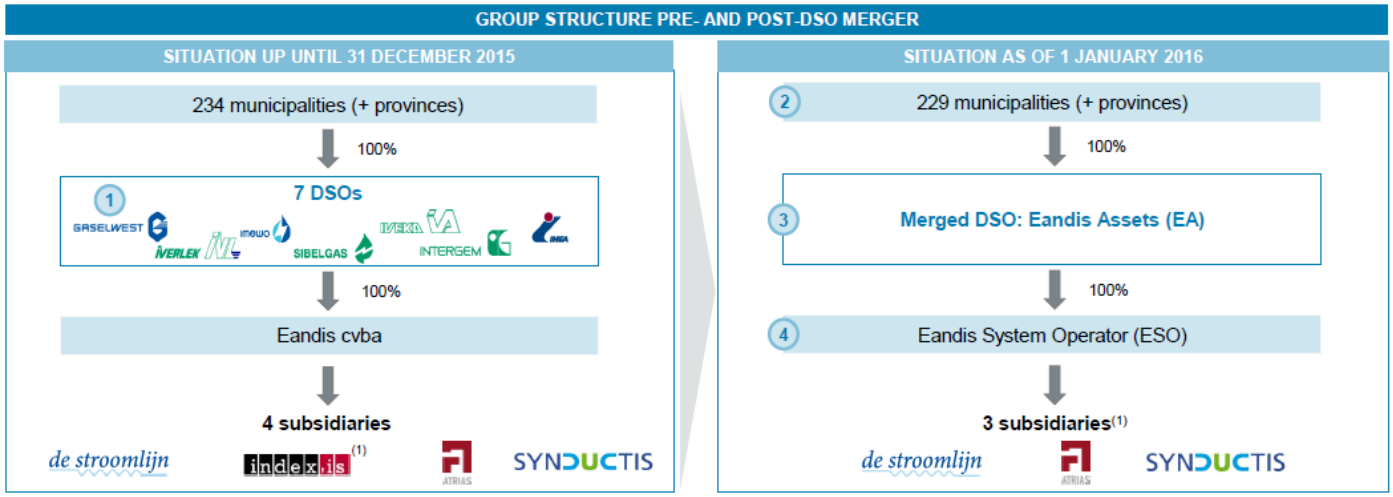
further takes into account an element of regulatory uncertainty as the new tariff methodology continues to evolve. We will consider stabilising the outlook if it becomes clear that the additional equity capital, in particular from the proposed transaction with SGID, will support leverage comfortably below 70% and FFO/net debt in the low teens.

We could downgrade the rating if the economic group's financial metrics appeared likely to remain weak, with consolidated net debt/RAB ratios persistently above 70%, and consolidated FFO/net debt ratio below 12%. Downward pressure could also result if underlying cash flow generation continued to weaken as a result of operational underperformance or unfavourable developments in the regulatory framework. Finally, we could adjust Eandis's rating downwards if we were to assess a lower probability of support from the Community of Flanders or if the rating of the sub-sovereign was downgraded.

Eandis System Operator CVBA (previously Eandis CVBA) is a Belgian utility, established in March 2006 and fully owned by Eandis Assets, an entity created through the merger of seven Flemish DSOs Gaselwest, IMEA, Imewo, Intergem, Iveka, Iverlek and Sibelgas, which took effect on 1 January 2016. Eandis Assets' share capital is currently 100% held by 229 municipalities and provinces within the Community of Flanders.

Exhibit 3

Eandis's group and ownership structure is evolving



Source: Eandis

Eandis operates, maintains and develops the regulated electricity and gas distribution networks on behalf of Eandis Assets, which owns the distribution network assets. In addition, Eandis is responsible for the metering activity and the operation of some other public service obligations. Through the Flemish Energy Decree of 8 May 2009, and with the explicit permission of the VREG, the Flemish region's electricity and gas distribution regulator, Eandis is appointed as the sole operator of Eandis Assets' networks. In addition, through Eandis Assets' articles of association, Eandis operates at `cost' basis, whereby all costs incurred by the company, including financing costs, are passed through to Eandis Assets. Therefore, all financial creditors and contractual counterparties have indirect recourse to Eandis Assets, which also guarantees the debt raised by Eandis under its €5 billion EMTN programme.

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