MOODY'S
INVESTORS SERVICE

Rating Action: Moody's places Eandis's A1 ratings on review for downgrade

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London, 06 October 2016 -- Moody's Investors Service (Moody's) has today placed the guaranteed A1 long-term issuer and the backed senior unsecured debt ratings of Eandis System Operator CVBA (Eandis) as well as the guaranteed (P)A1 senior unsecured programme rating of the company's EUR5.0 billion MTN programme on review for downgrade.

This action follows the company's announcement, on 3 October 2016, that the planned merger between the seven distribution system operators (DSOs) that own Eandis will not conclude and the merged entity Eandis Assets will not be formally realised. This in turn will impede the planned entry of State Grid International Development Limited (A1, negative) through State Grid Europe Limited, a wholly-owned subsidiary of State Grid Corporation of China (Aa3 negative), as a new shareholder for a 14% stake in Eandis Assets.

RATINGS RATIONALE

RATIONALE FOR RATING REVIEW

Today's rating action reflects that certain measures anticipated by Moody's and expected to restore Eandis's credit quality may not now be implemented. Absent the planned sale of a stake, or other actions to materially strengthen the company's balance sheet, Eandis's key financial metrics appear likely to remain persistently below the rating agency's guidance for the current rating. Eandis exhibited leverage measured through net debt to regulated asset base (RAB) of around 80% and funds from operations (FFO) to net debt below 10% as at December 2015, compared with Moody's guidance for Eandis's current A1 ratings of leverage comfortably below 70% and FFO/net debt in the low teens in percentage terms.

Following an extraordinary shareholder meeting on 3 October 2016, Eandis announced that the governing bodies of the Economic Group Eandis, which comprises Eandis and its seven owners, the DSOs Gaselwest, Imea, Imewo, Intergem, Iveka, Iverlek and Sibelgas, decided that the merger between the DSOs into Eandis Assets could not be concluded due to two conditions precedent not being fulfilled. Firstly, the Walloon municipalities have not been successful in setting up their own operational entity and remain members of DSO Gaselwest. Secondly, DSO Imea concluded that, based on a recent statement by the Flemish regulatory body, its requirement for maintaining separate tariff level as part of a merged DSO is unlikely to be fulfilled.

As a consequence of the merger not concluding, the capital increase, which would have seen State Grid Europe Limited acquire a 14% stake in the merged DSO Eandis Assets, will also not go ahead as planned.

In addition, a €100 million capital increase, received from the intermunicipal financing associations in July 2016 as part of the merger and recapitalisation of the business, will likely have to be reversed.

FACTORS TO BE CONSIDERED IN RATING REVIEW

The ratings review will consider the likelihood of an improvement in Eandis's capital structure in the very near term, taking into account any balance sheet strengthening measures that management or the DSOs' municipal shareholders may consider. The review will also re-assess the support assumptions underpinning the current ratings, particularly in the context of municipal governments having opposed the DSO merger, thereby derailing the restructuring process for the Economic Group Eandis.

The rating agency will endeavor to conclude the review within the next three months.

WHAT COULD CHANGE THE RATING UP/DOWN

Given the current rating review, upward pressure on the rating is unlikely over the medium term. The ratings could be confirmed if management or Flemish municipalities can agree on balance sheet strengthening measures that would support leverage comfortably below 70% and FFO/net debt in the low teens in percentage terms.

Conversely, Moody's could downgrade the rating if the Economic Group Eandis'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%. The rating agency could also downgrade Eandis's rating if it assessed a lower probability of support from the Community of Flanders or if the rating of the sub-sovereign was downgraded.

The methodologies used in these ratings were Regulated Electric and Gas Networks published in November 2014, and Government-Related Issuers published in October 2014. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

Eandis System Operator CVBA (previously EANDIS CVBA) is a Belgian utility, established in March 2006 and fully owned by the seven Flemish DSOs Gaselwest, Imea, Imewo, Intergem, Iveka, Iverlek and Sibelgas, whose share capital is currently 100% held by 233 municipalities and one province, predominantly within the Community of Flanders.

Eandis operates, maintains and develops the regulated electricity and gas distribution networks on behalf of the DSOs, which own 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 System Operator CVBA is appointed as the sole operator of the DSOs' networks. In addition, through the DSOs' articles of association, Eandis System Operator CVBA operates at 'cost' basis, whereby all costs incurred by the company, including financing costs, are passed through to the DSOs. Therefore, all financial creditors and contractual counterparties have indirect recourse to the DSOs, which also severally guarantee the debt raised by Eandis under its EUR5.0 billion EMTN programme.

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