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Rating Action: Moody's affirms RESA's A2 ratings; stable outlook

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London, 14 September 2017 -- Moody's Investors Service (Moody's) has today affirmed the A2 long-term issuer and senior unsecured ratings of RESA S.A. (RESA). The outlook on all ratings remains stable.

RATINGS RATIONALE

Today's rating affirmation follows the publication in July 2017 of a new tariff methodology for the five-year regulatory period starting in 2019 for electricity and gas distribution system operators (DSOs), including RESA, in the Walloon region of Belgium. The new tariff methodology published by the Walloon energy regulator (CWaPE) for the 2019-23 period includes the introduction of a revenue-cap model, moving away from the current cost-plus model.

Under the new tariff methodology, the revenue building block will comprise an allowance for costs, depreciation, tax and an allowed return on the Regulated Asset Base (RAB) of 4.05% (vanilla WACC, nominal) based on a notional gearing assumption of 52.5%. Certain defined non-controllable costs will remain a pass-through whilst allowed controllable costs will be updated annually for projected inflation less a productivity factor (X factor) of 1.5%. Differences between actual and allowed costs will be borne (1) by consumers in respect of non-controllable costs and (2) by DSOs in respect of controllable costs. Regulatory balances arising from the over- or under-recovery of revenues or costs will be clawed back two years later.

DSOs will not face targets relative to quality of service (Q factor) during the 2019-23 period, however the CWaPE will likely set up performance incentives for the following regulatory period.

The rating action reflects Moody's expectation that RESA's ratio of funds from operations (FFO) to net debt is likely to remain broadly stable in 2017 and 2018 at around 16-17%, before strengthening from 2019 onwards as a result of the shift to the new tariff methodology. In particular, RESA will benefit from a lower cost of debt (c. 1.6% currently) than that embedded in the WACC set by the CWaPE (2.7%).

Moody's adds that RESA's dividend policy, which assumes a payout ratio of 60% based on the restriction included in the bond documentation, further supports credit metrics in line with Moody's revised guidance for the current A2 ratings, which includes FFO/net debt in the mid-teens in the short term, rising into the high-teens by 2019 (both in percentage terms). The revised guidance (vs. a prior guidance based on net debt/RAB) reflects the characteristics of the new tariff methodology, notably the potential for a mismatch between regulatory and accounting depreciation.

Finally, RESA's ratings continue to be supported by (1) the low-risk business profile of its monopoly regulated electricity and gas distribution network operations in the Walloon region, underpinned by a relatively transparent and supportive regulatory framework, and (2) moderate investment requirements. These factors are balanced by (1) the short track record of the regulatory framework in the Walloon region in the context of European peers due to the recent transfer of tariff setting responsibilities from the national to the regional regulator; and (2) RESA's exposure to the weaker credit quality of the group it belongs to, Publifin SCIRL (Publifin), which is involved in higher-risk telecom and energy activities.

Moody's further notes the concerns that have arisen in past months in respect of the Publifin group's corporate governance. Moody's nevertheless believes that RESA's credit quality is partly insulated from that of Publifin by (1) the bond covenant package that restricts distributions if net debt/RAB is above 55%; and (2) the benefits from the ultimate ownership by the Province of Liege and other municipalities, which results in a conservative financial policy. Under the 2001 Walloon electricity and gas decrees, the share capital of a DSO such as RESA must be held directly or indirectly at least 70% by entities governed by public law, which includes municipalities or provinces.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects Moody's expectation that (1) RESA will maintain FFO/net debt in the mid-teens in the short term, rising into the high-teens (both in percentage terms) by 2019; and (2) the consolidated credit quality of Publifin will remain broadly in line with the current level.

WHAT COULD CHANGE THE RATING UP/DOWN

Given Moody's expectation of broadly stable credit metrics in the medium term, a rating upgrade is unlikely. Nevertheless, upwards pressure could develop on the rating in the long term if (1) distributions were to be moderated such that RESA's FFO/net debt were to rise above 25%; and (2) the consolidated credit quality of Publifin were to improve, most likely as a result of material gross debt reduction at parent company level.

Conversely, RESA's ratings could be downgraded if (1) its credit metrics fell below Moody's guidance for the A2 rating; (2) the consolidated credit quality of Publifin were to deteriorate materially, notably as a result of additional debt raised at parent company level; or (3) RESA were to be directly affected by the fallout of the corporate governance challenges at Publifin.

RESA S.A. owns and operates gas and electricity distribution networks in the province of Liege (Belgium) with a combined Regulated Asset Base in excess of EUR1.2 billion at year-end 2016. Its ultimate parent is holding company Publifin SCIRL, whose ultimate shareholders include the Province of Liege (54%) and 76 municipalities in the region of Liege.

The principal methodology used in these ratings was Regulated Electric and Gas Networks published in March 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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