FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms eustream at 'BBB'; Outlook Stable

Wed 30 Oct, 2024 - 12:10 ET

Fitch Ratings - Barcelona - 30 Oct 2024: Fitch Ratings has affirmed eustream, a.s.'s Long-Term Issuer Default Rating (IDR) at 'BBB' with a Stable Outlook. We have also affirmed the senior unsecured ratings of both eustream and SPP Infrastructure Financing B.V. (SPPIF) at 'BBB'. The latter's debt is guaranteed by eustream. eustream's Standalone Credit Profile (SCP) remains at 'bbb-'.

In our updated rating case, eustream's funds from operations (FFO) are expected to be depressed from 2025 onwards, albeit remaining on average at around EUR110 million, due to anticipated negligible Russian gas-transit volumes via Ukraine.

However, the overall ratings and Stable Outlook are supported by the recent tariffs approval in Slovakia, significant cash reserves on the company's balance sheet and a prudent financial policy to maintain net debt/EBITDA below 2.0x at all times.

KEY RATING DRIVERS

Long-Term Contracts at Risk: We see substantial risk to the gas transit and payments under eustream's long-term ship-or-pay transit contracts with Gazprom, which expire at end-2028. These contracts, which we calculate will account for more than half of the company's revenue in 2024, face a high likelihood of non-payment by Gazprom if at end-2024 the Ukraine-Russian transit agreement is not renewed in any form. In light of the lack of visibility over this process, we have excluded Gazprom income from our projections.

Expected Limited Flow: From 2025 onwards, we expect eustream's gas flow to reduce to below 7 bcm/year from above 17 bcm/year forecast for 2024 and 55 bcm/year in 2014-2021. This includes slightly more than 4 bcm/year for national consumption and the remainder for international transit mainly to the Czech Republic, Ukraine, and, potentially, also to Austria. This assumes the continuation of Russian gas transit through Turkish Stream II to Hungary, which limits any upside to international gas transit that we had previously expected via eustream's Slovak infrastructure.

Maintained Positive FCF Generation: Despite the significant deterioration in internal transit activity prospects, recently approved tariff increases will allow eustream's revenues to stabilise around EUR200 million and its EBITDA to settle at around EUR150 million. This, together with eustream's annual investments of no more than EUR10 million per year and negligible working-capital needs, results in around EUR100 million of annual free cash flow (FCF) post financial and fiscal charges.

Expected Gross Debt Reduction: We forecast EUR700 million in cash and cash equivalents at end-2024 as a result of suspended dividend payments for the past three years and its strong expected EBITDA of nearly EUR400 million for 2024. eustream has expressed full commitment to use the funds to repay its EUR500 million notes maturing in 2025, almost halving its gross debt. This, coupled with positive FCF generation, firmly positions eustream to maintain net debt/EBITDA at around 2.0x. This broadly corresponds to FFO net leverage of around 2.5x, even with materially lower-than-historical EBITDA.

Rebalanced Revenue Mix: Our current projections reflect 60% of revenues from domestic transactions, with an overall exposure to gas-in-kind (both from domestic and international transit) at around 12%. Despite the positive revenue mix rebalance reducing uncertainties, we remain cautious about the limitations of the Slovak regulatory framework, which allows for full volume risk and frequent tariff resets. A potential sharp tariff upside of around 60% under depressed volume flows is not yet included in our projections due to political risk associated with its effective implementation.

Positive Links with Stronger Parent: In our view, the stronger parent SPP Infrastructure a.s (SPPI) has 'low' legal incentives, but 'medium' strategic and operational incentives to support eustream, which accounts for around 20% of the former's consolidated EBITDA under our assumptions. The IDR and senior unsecured ratings of eustream continue to benefit from a one-notch uplift, reflecting such links with SPPI under Fitch's Parent and Subsidiary Linkage Rating Criteria.

DERIVATION SUMMARY

Compared with eustream, Fitch sees a significantly higher debt capacity for fully regulated gas transmission system operators (TSOs) and distribution system operators (DSOs) operating under mature regulatory frameworks, such as Snam S.p.A. (BBB+/Stable), REN - Redes Energeticas Nacionais, SGPS, S.A. (BBB/Stable), Czech Gas Networks Investments S.a r.l (BBB/Rating Watch Positive) or Italgas S.p.A. (BBB+/Stable).

NET4GAS, s.r.o. (BB/Positive) used to be eustream's closest rated peer as both companies own and operate gas transit pipelines in the Czech Republic and Slovakia, respectively. However, following NET4GAS's shift towards being a predominantly regulated gas TSO, their debt capacity trajectory has materially diverged, as well as their net leverage (2.7x FFO net leverage for eustream versus 8.0x for NET4GAS in 2024-2028).

The Romanian TSO SNTGN TRANSGAZ SA (BBB-/Stable) benefits from fully regulated EBITDA, although its operating cash flow is more volatile than most utility peers' due to still developing regulation. By contrast, eustream continues to show positive FCF generation due to limited capex requirements.

KEY ASSUMPTIONS

Fitch's Key Assumptions within our Rating Case for the Issuer

- Annual transited gas at 6.7bcm, of which 4.2bcm is for domestic needs

- Received gas-in-kind payments are a small percentage of gas transit volumes

- Transit tariffs to match inflation with a two-year time lag

- Gas prices declining towards EUR30/MWh by 2029

- Operating expenditure of around EUR50 million a year to 2029

- Tax rate at 25% on taxable income to 2029, accounting for the limited fiscal deducibility of depreciation & amortisation

- Capex around EUR10 million per year to 2029

- Dividend payments to be reinstated in 2027, leading to net debt/EBITDA slightly above 2.0x

- Full repayment of its 2025 EUR500 million notes and 60% refinancing of EUR500 million notes maturing in 2027

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- An upgrade is unlikely due to eustream's business profile and the shareholders' targeted capital structure

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Weakening of SPPI's credit quality or of its strategic and operational incentives to support eustream

- FFO net leverage above 2.75x on a sustained basis would be negative for eustream's SCP, but not necessarily for its Long-Term IDR

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: At FYE24, eustream had around EUR600 million of readily available cash alongside EUR50 million of undrawn committed revolving lines for back-up purposes, which will not be renewed on expiry in December 2024. Its liquidity position is also supported by access to SPPI's other available cash at group level through cash pooling and expected positive annual pre-dividend FCF of above EUR100 million until end-2026. This is expected to adequately cover EUR500 million debt maturity in February 2025.

ISSUER PROFILE

eustream is a Slovak national gas TSO, and a part of international infrastructure for the European gas transit. With an overall capacity of more than 80bcm per year on bi-directional flows, eustream operates a large-scale high-pressure gas transmission system of 2,273km of pipelines.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
SPP Infrastructure Financing B.V.				
senior unsecured	LT	BBB	Affirmed	BBB
eustream, a.s.	LT IDR	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Stable
senior unsecured	LT	BBB	Affirmed	BBB

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Pilar Auguets
Senior Director
Primary Rating Analyst
+34 93 467 8747
pilar.auguets@fitchratings.com
Fitch Ratings Ireland Spanish Branch, Sucursal en España
Av. Diagonal 601 Planta 4 Barcelona 08028

Jaime Sierra
Associate Director
Secondary Rating Analyst
+49 69 768076 275
jaime.sierrapuerta@fitchratings.com

Arkadiusz Wicik, CFA
Senior Director
Committee Chairperson
+48 22 103 3016
arkadiusz.wicik@fitchratings.com

MEDIA CONTACTS

Pilar Perez
Barcelona
+34 93 323 8414
pilar.perez@fitchratings.com

Tahmina Pinnington-Mannan
London
+44 20 3530 1128
tahmina.pinnington-mannan@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

Corporate Recovery Ratings and Instrument Ratings Criteria (pub. 02 Aug 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

eustream, a.s.	EU Issued, UK Endorsed
SPP Infrastructure Financing B.V.	EU Issued, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the “NRSRO”). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the “non-NRSROs”) and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.