FitchRatings

RATING ACTION COMMENTARY

Fitch Revises eustream's Outlook to Stable; Affirms IDR at 'BBB'

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Fitch Ratings - Milan - 12 Oct 2023: Fitch Ratings has revised the Outlook on eustream, a.s.'s Long-Term Issuer Default Rating (IDR) to Stable from Negative. Fitch has also affirmed eustream's Long-Term IDR and senior unsecured debt at 'BBB'. The Standalone Credit Profile (SCP) is assessed at 'bbb-'.

The Outlook revision mainly reflects the improved parent creditworthiness (SPP Infrastructure a.s.; SSPI) supported by good business prospects and regulatory developments in the storage and gas distribution businesses, respectively. Furthermore, it takes into account the much-reduced risk of over-hedging and the piling up of cash on balance. This has been supported by permanence of Russian gas flow, now incorporated in our eustream base scenario, although at the current depressed level.

We expect eustream to maintain a financial net debt-to-EBITDA ratio of about 2.0x in 2024-2028, which is consistent with historical management targets and our negative sensitivity for the rating of funds from operations (FFO) net leverage of 2.75x.

KEY RATING DRIVERS

SPPI's Improved Credit Profile: SPPI controls eustream, SPP-Distribucia a.s. and other low-leveraged gas storage infrastructure. We see an improvement in SPPI's credit profile based on strong fundamentals and earnings prospects for gas storage; significantly improved regulation and visibility over its gas distribution activities; and eustream's de-risking of its hedging position.

Positive Links with Parent: In our view, SPPI has 'low' legal incentives, but 'medium' strategic and operational incentives to support eustream, which accounts for slightly more than 35% 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 its stronger parent, SPPI, under Fitch's Parent and Subsidiary Linkage Rating Criteria.

Russian Gas Still Flowing: For the time being, Russian gas is still flowing through eustream's pipelines at an annual run rate of 13.5 billion cubic meters (bcm), compared with 44bcm/year on average during 2015-2021. Gazprom is honouring the capacity payments related to the transit, which are not impacted by the volume reduction. This allowed the company to accumulate EUR180 million of available cash at July end and, in conjunction with proactive risk management over historical gas hedging, have materially improved expected financial performance in 2023-2024, compared with our previous expectations.

We have reinstated, in our base case, Gazprom's ship-or-pay payments, estimating an EBITDA of about EUR140 million in 2023, mainly affected by the costly management of commodity hedges, and a rebound to EUR340 million over 2024 -2028. In the medium term, in an alternative scenario of nil Russian transit and payments, we estimate that the EBITDA should not drop dramatically, assuming transits covering Slovak and neighbouring central and eastern Europe (CEE) countries' gas needs.

Structurally Lower and Riskier Transit: Our projections see around 16bcm gas transited yearly throughout eustream's pipelines over the medium term compared with more than 55bcm/year in 2014-2021. We project Russian gas imports from Ukraine at 85% of the transited flow, mainly to cover the gas needs of Slovakia, Hungary and Austria. Notwithstanding the contractual ship-or-pay nature until 2028, Russian transits bear high risk, due to the unpredictable counterparty's behaviour. However, in light of the potential for short-term transit in absence of Russian gas, we have kept the debt capacity unchanged.

Effective Risk Management: From end-2022 until now, eustream has proactively managed its commodity hedging positions, allowing an effective de-risking of its hedging book for 2023-2024. The current residual exposure compares well with the cumulative gas in-kind expected to be received until end-2024. In the medium term, we estimate that eustream's decision of not entering in new hedges, would leave the company somewhat exposed to gas market prices.

Leverage Coherent with SCP: We expect eustream to generate annual pre-dividend free cash flow (FCF) of about EUR240 million at normalised gas price levels, leaving the company with enough levers to maintain its historical prudent target of 2.0x net debt/EBITDA, below the maximum 2.5x allowed by the shareholder agreement. As a result, we expect FFO net leverage to remain within our 2.75x negative sensitivity for the SCP of 'bbb-', without experiencing relevant breaches.

DERIVATION SUMMARY

Eustream has a significantly weaker business profile than fully regulated gas transmission system operators (TSOs) and DSOs in advanced regulations, 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/Stable) or Italgas S.p.A. (BBB+/Stable).

NET4GAS, s.r.o. (BB-/RWP) used to be eustream's closest rated peer given that both companies own and operate gas transit pipelines in the Czech Republic and Slovakia, respectively. However, eustream's gas route is more resilient as it is one of the few routes still used by Russia to Europe, unlike NET4GAS's. Also, the rating differential is explained by eustream's expected low leverage of below 2.7x compared with NET4GAS's forecast 8.0x for 2024-2026. However, NET4GAS's rating would likely benefit from the announced signing of an acquisition by CEPS.

The Romanian TSO SNTGN TRANSGAZ SA (BBB-/Stable) benefits from about 90% of regulatory asset-based EBITDA, although its operating cash flow is more volatile than most utility peers' due to still developing regulation. By contrast, eustream continue to show positive FCF generation due to limited capital expenditure (capex) requirements.

KEY ASSUMPTIONS

-16bcm of annual transited gas, out of which 13.5bcm are Russian gas flows honoured on contractual ship-or-pay basis

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

-Transit tariff escalated to inflation with a two-year time lag

-Gas price assumptions in line with Fitch's published oil and gas price deck of September 2023

-Operating expenditure of about EUR50 million a year to 2028

-Tax rate at 25% on taxable income to 2028

-Annual capex of below EUR10 million per year to 2028

-Dividend payments reinstated in 2024, leading to net debt/EBITDA slightly above 2.0x

-50% refinancing of its 2025 EUR500 million notes

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- In light of the company's business profile and the shareholders' targeted capital structure, we deem an upgrade very unlikely.

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 sustainably above 2.75x or evidence of permanent loss of a large part of the current transit income, would be negative for eustream' SCP, but not necessarily for its Long-Term IDR

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: At end-July 2023, eustream had more than EUR180 million of readily available cash and 170 million of undrawn committed revolving lines for back-up purposes (expiring in December 2024).

Its liquidity position is also supported by potential access to SPPI's other available cash at group level through cash pooling, only modest debt maturities until February 2025, and expected positive annual pre-dividend FCF of above EUR300 million until end-2024.

ISSUER PROFILE

eustream is a Slovak national gas TSO, and a crucial infrastructure for gas transit from Russia to European markets (especially Italy). 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.

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
eustream, a.s.	LT IDR	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Negative
senior unsecured	LT	BBB	Affirmed	BBB
SPP Infrastructure Financing B.V.				
senior unsecured	LT	BBB	Affirmed	BBB

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 28 Oct 2022) (including rating assumption sensitivity)

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

Climate Vulnerability in Corporate Ratings Criteria (pub. 21 Jul 2023) (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

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