RATING ACTION COMMENTARY

# Fitch Upgrades NET4GAS's IDR to 'BBB-' and Unsecured Notes to 'BBB'; Outlook Positive

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Fitch Ratings - Barcelona - 11 Dec 2024: Fitch Ratings has upgraded NET4GAS, s.r.o.'s Long-Term Issuer Default Rating (IDR) to 'BBB-' from 'BB' and its senior unsecured rating to 'BBB' from 'BB+'. The Outlook on the Long-Term IDR remains Positive. A full list of rating actions is below.

The two-notch upgrade on the IDR reflects NET4GAS ´s improving Standalone Credit Profile (SCP) both in terms of business profile and capital structure. The company's business mix has transitioned into a pure regulated network that merits a higher debt capacity, with no exposure to the gas transit business. Moreover, we believe the price determination for 2025 will allow the company to reduce its funds from operations (FFO) net leverage to 5.7x, from an expected 6.4x in 2024, and generate positive free cash flow (FCF).

The Positive Outlook reflects our expectation of further deleveraging in the sixth regulatory period (RP6) for 2026-2030 to below our revised positive sensitivity of 6.3x, assuming that the final determination for the period is broadly in line with the consultation document.

## KEY RATING DRIVERS

**Strong SCP Improvement**: The price determination for 2025 has been positive for NET4GAS's credit profile and we expect a supportive final decision for RP6. This should lead to FFO net leverage of around 5.5x over 2025-2026, versus 6.7x in our prior forecasts. We also expect its regulatory asset base (RAB) to expand significantly to more than CZK33 billion, which is closer to its book value of CZK42 billion and translates into a moderate net debt/RAB below 70%.

In our updated rating case for 2024-2028, we now expect NET4GAS´s total revenues to average CZK5.7 billion, 10% higher than our prior forecast. Importantly, the revenue is now solely derived from regulated network operations that have low business risk, in contrast to our prior forecast of 20% revenues being sourced from the higher-risk international gas transit business.

**Supportive Single Revenue Cap Model:** We now see NET4GAS as a pure gas transmission network operator with stable and predictable revenues and negligible volume risk. Starting from the 2025 tariff determination, both gas transport and transit activities are now remunerated under a framework that is akin to a single revenue cap model. The consultation document for RP6 also confirms the single revenue cap regime post-2025, where a shortfall or surplus in transit volumes would be allocated to a regulatory account, which would be neutral to regulated revenues over the RP. The improved business profile led us to relax the company's rating sensitivities.

**Capital Structure to Improve:** Over the next two years, we expect NET4GAS to sharply reduce its gross debt with the repayment of CZK12 billion of maturities in 2025-2026 by using its own cash reserves. We also expect the company to refinance its remaining CZK4 billion debt due in the same period with new long-term credit facilities. The debt reduction is credit-positive and mirrors the reduced expected EBITDA at CZK4.2billion on average in our forecasts, versus the CZK7.3 billion expected before Russia's invasion of Ukraine.

**Upside from RP6:** If the remuneration for RP6 is approved by the regulator as presented in the consultation document, we project annual FFO of around CZK3 billion and pre-dividend free cash flow (FCF) on average at CZK2 billion across the new regulatory period. This would represent a substantial improvement on our prior forecasts and would allow a gradual deleveraging to below the revised positive sensitivity of 6.3x FFO net leverage. The deleveraging would also depend on NET4GAS's new dividend policy.

**Standalone Approach:** We rate NET4GAS based on its SCP, due to weak links with its stronger Czech parent, the state-owned electricity transmission system operator (TSO) CEPS, a.s. NET4GAS has no legal ties to CEPS, which does not guarantee any NET4GAS's debt, and there is no cross-default language related to NET4GAS under CEPS's debt documentation. Operational and strategic links are also weak, in our view, due to limited opportunities for synergies and joint value creation. However, we could revisit the assessment once we have long-term visibility over CEPS's stance towards the company.

**Senior Unsecured Rating Uplift:** Under our methodology, NET4GAS's senior unsecured rating benefits from a one-notch uplift from the IDR, due to the significantly increased contribution of regulated activities to EBITDA in a regulatory framework that we deem reliable.

## DERIVATION SUMMARY

Following its transition to become a regulated gas TSO under the single revenue cap model, NET4GAS's closest peer is the large Czech gas distributor Czech Gas Networks Investments S.a r.l (CGNI; BBB/Rating Watch Positive), as they share the same operating environment, regulator and supportive regulations. On the other hand, Fitch sees a slightly higher debt capacity for CGNI (6.7x negative sensitivity at BBB versus 6.3x for NET4GAS), given CGNI's longer record of fully regulated revenues.

Compared with central and eastern European gas distributor peer, SPP - distribucia, a.s. (SPPD; A-/Stable), NET4GAS has a higher debt capacity, benefiting from more mature regulations. However, SPPD's conservative capital structure with an average FFO net leverage below 2.5x explains its higher 'a' SCP. SPPD's IDR is capped at one notch above the consolidated credit profile of its immediate parent, SPP Infrastructure, a.s. (SPPI), in line with our Parent and Subsidiary Linkage (PSL) Criteria.

Romanian-based SNTGN TRANSGAZ SA (BBB-/Stable) has a less defensive business profile than NET4GAS. This is due to its material cash flow volatility stemming from large regulatory correction adjustments. However, Transgaz's expected FFO net leverage is much more conservative at an average of around 4.0x, ultimately resulting in the same rating as NET4GAS.

NET4GAS's business risk is higher than that of the Italian transportation system operator Snam S.p.A. (BBB+/Stable), due to better regulatory features in Italy, such as a longer record of fully independent regulation. NET4GAS's leverage is similar to that forecast for Snam, and the rating differential is mostly explained by our view of lower business risk at the Italian operator.

## KEY ASSUMPTIONS

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

-Revenues in 2025 based on the price determination, and in 2026-2028 based on the consultation paper for RP6 published by the regulator

-Fitch-defined EBITDA to average CZK4.2 billion a year until 2028

-Broadly neutral working capital over 2025-2028

-Annual capex of CZK1.2 billion until 2028

-Cash taxes on average at 27% of pretax profit until 2028

-Cost of debt to average 4.3% until 2028

-Repayment of CZK10 billion debt maturity in 2025 and CZK6 billion in 2026, largely with NET4GAS's expected own cash of CZK12 billion and refinancing the remaining amount

-No dividend over 2024-2026. Dividends to be reinstated in 2027 at a level commensurate with annual net income

## RATING SENSITIVITIES

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

-Material negative regulatory developments affecting revenues' level and predictability, for example, by lower- than-expected tariffs or renewed exposure to commercial risk arising from the international gas transit business

-FFO net leverage above 7x and FFO interest coverage below 4.0x

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

-Clear commitment towards a financial policy that is coherent with an FFO net leverage below 6.3x, coupled with RP6 tariffs being aligned with expectations and providing satisfactory long-term revenue visibility

-Stronger legal, strategic or operational links with CEPS or, indirectly, with the Czech government to support NET4GAS under our PSL Criteria or GRE Criteria

## LIQUIDITY AND DEBT STRUCTURE

We forecast NET4GAS's cash on balance sheet at more than CZK10.5 billion at end-2024. This, together with expected positive FCF generation of more than CZK1.5 billion in 2025, is more than sufficient to cover the almost CZK10 billion financial debt maturities next year.

## ISSUER PROFILE

NET4GAS is the Czech Republic's national gas TSO and operates the infrastructure for gas transit to central European markets.

## 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 |
|---|---|---|---|---|
| NET4GAS, s.r.o. | LT IDR | BBB- Rating Outlook Positive | Upgrade | BB Rating Outlook Positive |
| senior unsecured | LT | BBB | Upgrade | BB+ |

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

**Antonio Totaro**
Senior Director
Committee Chairperson
+39 02 9475 8280
antonio.totaro@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

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## APPLICABLE CRITERIA

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

Government-Related Entities Rating Criteria (pub. 09 Jul 2024)

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

Corporate Rating Criteria (pub. 06 Dec 2024) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 06 Dec 2024)

## 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

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|---|---|
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