FitchRatings

Fitch Affirms innogy at 'BBB+'; off RWN; Stable Outlook

Fitch Ratings-London/Warsaw-31 August 2018: Fitch Ratings has affirmed innogy SE's Long-Term Issuer Default Rating (IDR) at 'BBB+' and Short-Term IDR at 'F2'. The agency has also affirmed the 'A-' senior unsecured ratings of innogy and innogy Finance BV. The ratings have been removed from Rating Watch Negative (RWN). A Stable Outlook is assigned to the Long-Term IDR.

Fitch has aligned innogy's ratings with those of E.ON SE (BBB+/Stable) due to the planned acquisition of innogy by E.ON through an exchange of assets and participations with RWE AG (BBB/Rating Watch Evolving), which we expect to be finalised in late 2019. innogy's standalone credit profile continues to be commensurate with its 'BBB+' rating.

The ratings were placed on RWN on 14 March 2018 after announcement of the planned asset swap between E.ON and RWE.

KEY RATING DRIVERS

Asset Swap Plans: In March 2018 E.ON and RWE announced plans of an asset swap between the two, which included shares in and assets held by innogy. As part of the transaction E.ON will receive the innogy stake owned by RWE (76.8%) in return for a 16.67% shareholding in E.ON issued to RWE. E.ON will also transfer to RWE innogy's and E.ON's renewable assets, as well as innogy's gas storage assets and its participation in the Austrian energy utility Kelag and E.ON's minority stakes in the RWE-operated power plants Emsland and Gundremmingen. In addition E.ON will receive EUR1.5 billion in cash from RWE at the closing of the transaction.

Asset Swap Progress: E.ON, RWE and innogy have made progress towards the asset swap since the March 2018 announcement. This includes conclusion of a voluntary public takeover offer in July 2018, which was made to innogy's minority shareholders by E.ON and which raised E.ON's future stake in innogy to 86.2% from 76.8% to be acquired from RWE. Also in July 2018 innogy concluded two binding agreements each with E.ON and RWE, which aim for a smooth integration process and fair and equal treatment of employees and, in Fitch's view, reduce execution risks for the transaction.

We assume that the transaction will be concluded in late 2019 as the asset swap is complex and requires approvals from regulatory bodies in various jurisdictions. Until then innogy will operate as a separate business with an independent supervisory board and an agreement on basic principles between innogy and RWE providing for a legal basis for innogy's independence from RWE.

Ratings Aligned with E.ON's: The acquisition of 86.2% of innogy's shares as well as the restructuring of innogy's business with the disposal of renewables to RWE have led to the alignment of innogy's ratings with those of E.ON. We assume that the legal integration of both companies will take place in late 2019, which will imply the same strategy and gradual unification of operations as well as consolidation of innogy's debt by E.ON. This means E.ON's ratings will now drive innogy's ratings.

Standalone Credit Profile at 'BBB+': Fitch assesses innogy's standalone credit profile at the same level as E.ON's, corresponding to an IDR of 'BBB+'. innogy's EBITDA is derived mostly from the grid & infrastructure business (66% in 2017), of which more than 50% is from the predictable and regulated distribution of electricity and gas in Germany and central Europe. This underpins a single-notch uplift to the senior unsecured rating of innogy. We forecast innogy's funds from operations (FFO) adjusted net leverage to remain at about 4.5x in 2018-2019, still adequate for the standalone profile.

DERIVATION SUMMARY

More than half of innogy's cash flow is generated by regulated networks, while close to a fifth comes from a well-diversified renewables generation portfolio supported by feed-in-tarrifs or other similar mechanisms. The remainder comes from retail, gas storage, heat and combined heat and power generation. innogy is not exposed to conventional generation. Overall we evaluate innogy's standalone credit profile as strong, broadly in line with some other utilities peers such as E.ON, Iberdrola, S.A. (BBB+/Stable) and Enel S.p.A. (BBB+/Stable).

KEY ASSUMPTIONS

Fitch's Key Assumptions within our Rating Case for the Issuer
- The acquisition of innogy by E.ON proceeding as planned without any significant regulatory hurdles and being completed in late 2019
- No material changes to the regulatory framework for distribution in innogy's areas of operations, leading to stable EBITDA
- Renewables capacity rising to 4.0GW in 2019 from 3.5GW in 2017
- Net capex and acquisitions of EUR4 billion to EUR5 billion in total over 2018-2019
- Dividend payout unchanged at EUR1.2 billion in 2019

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
- A positive rating action is unlikely until the asset swap is finalised. After the asset swap the positive rating guidelines for E.ON will apply to innogy, including nuclear and lease adjusted FFO net leverage sustainably below 4.5x.

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- We do not anticipate a negative rating action until the asset swap completion when the negative rating guidelines for E.ON will apply to innogy, including nuclear and lease adjusted FFO net leverage consistently above 5.0x or an intensive capex programme and an ambitious dividend policy.

LIQUIDITY

Adequate Liquidity: At end-June 2018 innogy had cash and cash equivalents of EUR1.1 billion, current marketable securities reported at EUR2.4 billion and committed unused credit facilities of EUR2 billion. This compared with current financial liabilities of EUR3.8 billion and negative free cash flow for 2018 forecasted by Fitch of about EUR1.3 billion.

In January, May and July 2018 innogy successfully placed a total of EUR2.25 billion of new senior unsecured bonds.

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Summary of Financial Statement Adjustments
Fitch used a 8x multiple to capitalise operating lease. We applied a 30% haircut to the value of fixed-income marketable securities and a 60% haircut to the value of equity-like marketable securities when calculating readily available cash. Fitch applied also a fair value adjustment to senior unsecured bonds, related to valuation difference from debt transfer, as per innogy's 2017 annual report.

Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Criteria (pub. 23 Mar 2018) (https://www.fitchratings.com/site/re/10023785)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018) (https://www.fitchratings.com/site/re/10024585)
Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018) (https://www.fitchratings.com/site/re/10036366)
Sector Navigators (pub. 23 Mar 2018) (https://www.fitchratings.com/site/re/10023790)

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