Fitch Affirms innogy at 'BBB+'; Stable Outlook

Fitch Ratings - Frankfurt am Main - 31 July 2019:

Fitch Ratings has affirmed innogy SE's Long-term Issuer Default Rating (IDR) at 'BBB+', with a Stable Outlook, and senior unsecured rating of 'A-'. It has also affirmed innogy Finance B.V's senior unsecured rating at 'A-'.

The rating affirmation reflects continued progress in innogy's planned acquisition by E.ON SE (BBB+/Stable), with the first closing likely before end-2019. Fitch aligns innogy's ratings with those of E.ON while also taking into account their standalone credit profiles. We estimate average funds from operations (FFO) adjusted net leverage at 4.4x over 2019-2022, within our rating guidelines of 4.5x for 2019. It is also well within our rating guidelines for E.ON at 5.0x from 2020 onwards.

Key Rating Drivers

E.ON Transaction in Progress: Following the conclusion of the public takeover offer in July 2018, E.ON has secured an 89.2% stake in innogy. Subject to antitrust approval potentially involving asset sales in retail, due at latest by early November 2019 (including possible extension), the first closing of the transaction should follow shortly thereafter. innogy's sale of the Czech gas grid in February 2019 removes one of the potential uncertainties in the process and reduces pro-forma economic net debt of E.ON Group for 2019 by EUR2.3 billion. With regulated EBITDA due to increase to 70% of group total from around 60%, E.ON is expected to give mid-term guidance for the new group, including innogy, in March 2020.

Higher Visibility in Regulated: With a regulatory asset base (RAB) of EUR13.5 billion (including the Czech gas grid), Energy Networks contributed 71% to innogy's EBITDA in 2018. Germany, at 73% of divisional EBITDA, has five-year regulatory periods for gas from 2018 and power from 2019. The German Federal Supreme Court has recently upheld the regulator's initial indications of allowed returns on equity for both gas and electricity, raising the visibility of regulated cash flows. The merger will combine complementary businesses as innogy is the number one distribution system operator (DSO) in German power and E.ON the number one DSO in gas. However, there is some regulatory reset risk in Hungary and Poland, which have new regulatory periods starting in 2020 and in Slovakia in 2021.

Retail Increasingly Challenging: Retail contributed 20% to innogy's 2018 EBITDA, a figure we expect to fall to around 15% in 2019. This business faces major challenges, not just in the UK from competitive pressures and regulatory uncertainty but also from margin pressure due to increased wholesale costs in Germany. It is far from clear how subsidiary NPower resolves the issues facing the UK supply business and how can E.ON help to stem losses. innogy's substantial eastern European business is performing strongly, but earnings are threatened by regulatory risk, particularly in Poland. However, as wholesale prices have fallen back recently, these risks may recede, supporting margins.

Rating Alignment with E.ON: Overall, innogy's credit metrics are very similar to last year's rating case and remain marginally outside our guidelines for 2019. However, even without the E.ON transaction, average credit metrics over our four-year rating horizon remain within our guidelines, albeit with limited leverage headroom. Given that the ratings of innogy are aligned with E.ON's, our negative guidelines of 5.0x FFO net (nuclear) adjusted leverage for E.ON will apply to innogy from 2020 and we estimate credit metrics for innogy will remain well within this level.
Derivation Summary

More than half of innogy's cash flow is generated by regulated networks, and about 15% comes from a quasi-regulated renewables generation portfolio, with the rest largely from retail supply. Overall we evaluate innogy's standalone credit profile as strong, broadly in line with that of some utilities peers, such as E.ON (BBB+/Stable), Iberdrola, S.A. (BBB+/Stable) and SSE plc (BBB+/Negative).

Due to the planned acquisition by E.ON, Fitch ceased to rate innogy on a standalone basis and aligned its ratings with those of E.ON. This change in approach has no impact on innogy's ratings as the company's standalone credit profile is similar to the consolidated credit profile of E.ON.

Key Assumptions

Key Assumptions for our Rating Case for innogy include:

- Grids & infrastructure earnings in line with management's guidance
- Wind load factors for renewables averaging 32% over 2019-2022
- Slow earnings recovery in retail division, specifically in Germany, Benelux & the UK
- Capex of EUR2,650 million, below management's guidance, in 2022 reflecting delay to final investment decisions and execution risk in renewables

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- A positive rating action is unlikely due to the planned acquisition by E.ON.

From 2020 positive guidelines for E.ON of nuclear- and lease-adjusted FFO net leverage below 4.5x on a sustained basis will apply, assuming that the merger is successfully implemented.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- A negative rating action could be triggered by FFO adjusted net leverage materially above 4.5x or fixed charge cover materially below 3.0x, in particular if triggered by liquidity shortage, over-investment or an excess dividend payment.

From 2020 our negative guidelines for E.ON of nuclear- and lease-adjusted FFO net leverage consistently above 5.0x will apply, assuming the acquisition and the associated asset swap are successfully implemented.

Liquidity and Debt Structure
At end-2018 innogy had cash and cash equivalents of EUR2 billion, current (Fitch-adjusted) marketable securities of EUR1.5 billion and committed unused credit facilities totaling EUR2.8 billion. This compares with current financial liabilities of EUR2.6 billion and forecasted negative free cash flow for 2019 of around EUR2.2 billion.

**ESG CONSIDERATIONS**

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity.

**Summary of Financial Adjustments**

Operating leases capitalised at a standard multiple of 8x

Fitch applies a 30% haircut for fixed-income instruments and a 60% haircut for equity-like instruments within reported marketable securities

**Public Ratings with Credit Linkage to other ratings**

innogy's rating is aligned to E.ON's IDR under our Parent-Subsidiary Linkage criteria.

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<td>ENTITY/DEBT</td>
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| innogy SE      | LT IDR | BBB+  
|                |        | Affirmed|
|                | ST IDR | F2     
|                |        | Affirmed|
| senior unsecured | LT    | A-     
|                |        | Affirmed|
| innogy Finance B.V. |       |         |
| senior unsecured | LT    | A-     
|                |        | Affirmed|

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Applicable Criteria

Sector Navigators (pub. 23 Mar 2018)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)
Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018)
Corporate Rating Criteria (pub. 19 Feb 2019)
Short-Term Ratings Criteria (pub. 02 May 2019)

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Dodd-Frank Rating Information Disclosure Form
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