FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades CDP RETI to 'BBB'; Outlook Stable; Removes UCO

Mon 20 Dec, 2021 - 10:01 ET

Fitch Ratings - Milan - 20 Dec 2021: Fitch Ratings has upgraded CDP RETI SpA's Long-Term Issuer Default Rating (IDR) and senior unsecured rating to 'BBB' from 'BBB-'. The Outlook on the Long-Term IDR is Stable. The ratings have been removed from Under Criteria Observation (UCO) status.

The upgrade of CDP RETI, which has a Standalone Credit Profile (SCP) level of 'bbb', reflects the recent upgrade of its parent Cassa depositi e prestiti SpA (CDP; BBB/Stable), which previously constrained CDP RETI's IDR.

The ratings were also under UCO in relation to Fitch's recently updated Parent and Subsidiary Linkage (PSL) Rating Criteria.

CDP RETI's SCP continues to display a low and resilient loan-to-value ratio, sound interest coverage and limited refinancing risk. These strengths are partially offset by a structurally weak liquidity profile, with no back-up credit lines and limited diversification of assets. Solid leverage metrics are underpinned by regulated and cash-generative operating assets with limited exposure to volume and price risks. This results in high visibility over dividends through to 2023, notwithstanding the envisaged contraction in weighted average cost of capital (WACC) and ongoing pandemic-related uncertainties.

KEY RATING DRIVERS

Removal of Parental Rating Constraint: The upgrade of CDP's rating to "BBB" (see "Fitch Upgrades Cassa Depositi e Prestiti to 'BBB' on Sovereign Rating Action; Outlook Stable", published 16 December 2021) removes the constraint previously capping CDP RETI's IDR at 'BBB-' in the presence of a SCP of 'bbb'.

This occurred while the company was also under UCO due to the updated PSL criteria. Based on the new criteria, should CDP RETI's SCP become stronger than the parent's rating, the company could be rated up to two notches above the parent, due to 'porous' legal ringfencing and access and control, while it was capped by the parent's rating under the previous version of the criteria. In the case of CDP RETI's SCP becoming weaker than CDP's rating, we would expect an equalisation of the ratings of the two companies (a benefit for CDP RETI), reflecting the 'medium' level of legal and strategic incentive to support in combination with the 'high' operational incentive to support.

Holding Company Features: CDP RETI is a long-term holder of strategic equity stakes in Snam S.p.A. (BBB+/Stable; around 31%) and Terna S.p.A. (around 30%) - the two transmission system operators (TSOs) of the Italian gas and electricity systems, respectively - and in Italgas S.p.A. (BBB+/Stable; around 26%), a leading gas distribution operator (DSO). Fitch does not expect other relevant investments. CDP RETI appoints six of nine board directors for Snam and Italgas and six out of 13 for Terna. It retains strong control over the companies' dividend policies.

In assessing CDP RETI's SCP, we considered the drivers of our methodology for investment holding companies as well as pro forma, proportionately consolidated metrics, which confirm the 'bbb' SCP assessment.

'bbb' BISR: The dividend-weighted average credit quality of CDP RETI maps to a 'bbb' blended income stream (BISR) rating. This is one notch lower than the 'bbb+' average quality of the cash flow arising from its holdings, due to structural subordination of the dividends. We expect Snam to contribute around 54%, Terna 35% and Italgas 11% to CDP RETI's underlying dividends until 2023.

Low Asset Diversification: In line with its key strategic role, CDP RETI has a more concentrated and stable approach towards its portfolio compared with the average investment-holding company. All three companies share a similar sector, country and regulator as well as similarities within their regulatory frameworks. This limits any explicit notching uplift for diversification of the 'bbb' BISR under our criteria.

Neutral Supplementary Factors: CDP RETI's SCP benefits from strong dividend coverage in mid-teen multiples and a conservative loan-to-value ratio of around 20%, after applying a haircut based on our methodology. Such strong supplementary factors are counterbalanced by debt maturities that are structurally reliant on external refinancing. The medium-term gross debt/dividend ratio is commensurate with the current 'bbb' SCP category and we forecast it to progressively decline to 3.1x in 2023 from 3.6x currently, on expected rising dividends and stable indebtedness.

Regulatory Visibility: CDP RETI's holdings operate within a highly transparent regulatory regime with a long record and minimal exposure to price and volume risk. Italgas, Terna and Snam are in their fifth regulatory periods that span until 2023 (for TSOs) and 2025 (for DSOs and gas storage), with the main uncertainty within these timeframes related to the interim revision of the rate of return on regulated asset base (RAB) expected in 2022.

We expect a significant WACC reduction of around 80-100bps based on the second consultation document for all three companies. On the other hand, we deem that the implied contraction of returns will be mitigated by managerial actions preserving the announced dividend targets.

DERIVATION SUMMARY

CDP RETI does not have close peers. However, it has some similarities with Criteria Caixa, S.A., Unipersonal (BBB+/Negative) and, to a lesser extent, with the parent of regulated companies like National Grid Plc (BBB-/Stable), Kemble Water Finance Limited (B+/Negative) and Osprey Acquisitions Limited (BB+/Stable).

CDP RETI is smaller in terms of dividends received and is less diversified than Criteria Caixa, but benefits from the more stable performance of its assets. This is highlighted by its investments in Italgas, Terna and Snam, which all operate in the same country and sector and share the same regulator, whereas Criteria Caixa has investments across different sectors but primarily in Spain. CDP RETI benefits from better access to dividends than UK holdcos (i.e. no lock-up or other restrictions on dividends distributions from underlying companies), which reduces the rating differential between holding and operating companies.

KEY ASSUMPTIONS

- Dividends received gradually increasing to over EU540 million by 2023

- Low operating expenses of around EUR2 million a year up to 2023

- No financial investments over the next three years

- Dividends distribution modelled to enable almost neutral FCF

- Around EUR75 million-95 million of cash on balance sheet

- Gross debt remaining around EUR1.7 billion over the next three years

_ Cost of debt averaging 1.3% to 2023

RATING SENSITIVITIES

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

- Positive rating action or an upgrade of CDP's IDR would result in a similar action on CDP RETI's IDR

- An upgrade of CDP RETI's SCP, which we deem unlikely given the company's dividend policy and the ratings of the underlying assets

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A downgrade of the operating companies could be negative for the SCP, but not for the IDR assuming that the links with the parent, CDP, remain unchanged.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Sustainable Liquidity: CDP RETI's liquidity is structurally weak for an investment-grade holding/parent company, as it relies entirely on external market/parent refinancing for its EUR750 million bond maturing in May 2022. Also, the company does not usually refinance most of its maturities in advance.

However, we view its 2022 refinancing risk as manageable due to its sound financial profile, performing operating assets and established relationship with capital and banking markets as demonstrated in 2020 by the successful refinancing of its two term loans totalling EUR938 million with a 0.8% coupon. Furthermore, we expect CDP to remain committed to supporting refinancing at market rates if needed.

CDP RETI had readily available cash of around EUR73 million at end-2020, but no committed revolving credit facilities (RCFs). The company has structurally neutral free cash flow (FCF), since under its bylaws almost all dividends received from its investments are distributed to shareholders.

ISSUER PROFILE

CDP RETI operates as an investment vehicle that support the development of strategic infrastructure in Italy's gas and electricity sectors. The company has stakes in Italgas, a gas DSO, as well as Snam and Terna, Italian TSOs. CDP RETI is owned by CDP which has a 59% stake, alongside State Grid Europe Limited (SGEL; 35%) and local institutional investors (6%).

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍			PRIOR ⬍
CDP RETI SpA	LT IDR	BBB Rating Outlook Stable	Upgrade	BBB- Rating Outlook Stable
senior unsecured	LT	BBB	Upgrade	BBB-

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Nicolò Meroni
Director
Primary Rating Analyst
+39 02 879087 296
nicolo.meroni@fitchratings.com
Fitch Ratings Ireland Limited Sede Secondaria Italiana
Via Morigi, 6 Ingresso Via Privata Maria Teresa, 8 Milan 20123

Carlos Baeta
Senior Analyst
Secondary Rating Analyst
+44 20 3530 2616
carlos.baeta@fitchratings.com

Antonio Totaro
Senior Director
Committee Chairperson
+39 02 879087 297
antonio.totaro@fitchratings.com

MEDIA CONTACTS

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Stefano Bravi
Milan
+39 02 879087 281
stefano.bravi@fitchratings.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

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

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Investment Holding Companies Rating Criteria (pub. 12 Nov 2021) (including rating assumption sensitivity)

Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

CDP RETI SpA	EU Issued, UK Endorsed

DISCLAIMER

PROVIDED ANOTHER PERMISSIBLE SERVICE OR ANCILLARY SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF PERMISSIBLE SERVICE(S) FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) OR ANCILLARY SERVICE(S) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

 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.
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.

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.

Corporate Finance   Utilities and Power   Europe   Italy