

Rating Action: Moody's upgrades Canal de Isabel's ratings to Baa1; changes outlook to stable

29 Sep 2020

Madrid, September 29, 2020 -- Moody's Investors Service, ("Moody's") has today upgraded to Baa1 from Baa2 the long-term issuer rating and the senior unsecured rating of Canal de Isabel II, S.A. (Canal). Concurrently, Moody's upgraded the company's standalone baseline credit assessment (BCA) to baa1 from baa3. The outlook has changed to stable from positive.

RATINGS RATIONALE

Today's rating action reflects the company's strong financial profile and low leverage, which are considered commensurate with a Baa1 rating. The rating action also takes into account the confirmation from the audited 2019 financial statements that the previous risk of an early repayment of the EUR500 million senior unsecured bonds due in February 2025 (the Bonds) has been permanently removed.

The upgrade of the BCA to baa1 also reflects Canal's strong financial metrics, which will continue to be supported by the company's monopolistic position as the provider of integrated water services in the region of Madrid and its relatively low leverage. Notwithstanding the impact of the coronavirus outbreak, which will drive a decrease in the annual volumes of water invoiced for the whole-year 2020 (anticipated at around -3% year on year) and a freeze of the applicable service tariffs which may extend until the end of 2021, Canal's Funds From Operations (FFO) /Net Debt ratio will remain above 40% for at least the next eighteen months.

Governance considerations are incorporated into the rating, and more particularly the baa1 BCA continues to reflect a past record of M&A activity which has resulted in a significant negative impact on the company and a history of lengthy legal investigations involving Canal's former management in Colombia and Spain. Furthermore, in the past, the company's solid financial profile has been challenged by a financial policy that has not emphasized the importance of certainty in terms of the company's liquidity position. Nevertheless, the removal of the technical event of default in February 2020 was positive.

Given its 100% ownership by Comunidad Autonoma de Madrid (Baa1 stable) and other local municipalities, Canal's board members are appointed by local public authorities and the Board will always need to operate within the framework of local politics. Moody's recognizes the oversight and implicit support from the Comunidad Autonoma de Madrid by an assumption of high support and high dependence under its Government-Related Issuers Methodology, published in February 2020. However, the rating agency does not assign any rating uplift for the possibility of extraordinary government support, as the company's standalone BCA is currently positioned at the same rating level of its majority owner, the Comunidad Autonoma de Madrid.

OUTLOOK

Canal's rating is currently capped at the rating level of its owner the Comunidad Autonoma de Madrid. Furthermore, a one notch downgrade in the BCA is unlikely to result in a downgrade of Canal's rating. Consequently, the rating outlook is stable, reflecting the stable outlook on the Comunidad Autonoma de Madrid.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

WHAT COULD CHANGE THE RATING UP

Canal's rating could face upward pressure if the Comunidad Autonoma de Madrid is upgraded, provided that (1) Canal's financial profile remains strong and in line with its current financial metrics; and (2) the company's governance risk is not considered as having a discernible negative impact on the rating.

WHAT COULD CHANGE THE RATING DOWN

Any deterioration in the ratings or outlook of the Comunidad Autonoma de Madrid would likely result in a corresponding adjustment of Canal's rating and/or outlook.

Canal's BCA could face downward pressure if (1) the company's business risk profile were to increase significantly due to, for example, adverse regulatory developments or evidence of political interference; or (2) the company's financial risk profile were to deteriorate materially, such that FFO/Net Debt would stay consistently below 20%.

PRINCIPAL METHODOLOGIES

The methodologies used in these ratings were Regulated Water Utilities published in June 2018 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1121971 , and Government-Related Issuers Methodology published in February 2020 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1186207 . Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of these methodologies.

CORPORATE PROFILE

Canal is the monopoly provider of water collection, abstraction, supply, sanitation and other water and wastewater related services in the region of Madrid. Canal is also responsible for the provision of integrated water services in the municipalities of Caceres (Extremadura) and Lanzarote (Canary Islands). Aside from the Spanish operations, which account for c. 94% of consolidated revenue and nearly 100% of EBITDA at the end of 2019, Canal provides water related services, including metering and commercial management of water supply and treatment operations in Latin America, primarily in Colombia, Brazil, Ecuador and the Dominican Republic.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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