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## Research Update:

# Dutch Electricity And Gas Utility Enexis Upgraded To 'AA-' On Stronger Credit Metrics; Outlook Stable


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## Overview

- Dutch electricity and gas distribution network operator Enexis Holding N.V. continues to report solid earnings and cash flow coverage of debt measures.
- We believe that Enexis' Standard & Poor's-adjusted credit metrics will remain commensurate with a "modest" financial risk profile despite the regulator's relatively challenging draft method decision for the tariff set applicable from Jan. 1, 2014.
- We are therefore raising our long-term corporate credit rating on Enexis to 'AA-' from 'A+'.
- The stable outlook reflects our opinion that Enexis will be able to sustain adjusted funds from operations (FFO) to debt at about 25%.

## Rating Action

On Aug. 15, 2013, Standard & Poor's Ratings Services raised its long-term corporate credit ratings on Dutch electricity and gas distribution network operator Enexis Holding N.V. and its subsidiary Enexis B.V. (jointly Enexis) to 'AA-' from 'A+'. At the same time we raised the ratings on Enexis' unsecured debts to 'AA-' from 'A+'. The outlook is stable.

## Rationale

The rating actions reflect our view that Enexis' Standard & Poor's-adjusted ratio of funds from operations (FFO) to debt will remain at around 25% on a sustainable basis, which is in line with our guidance for a rating of 'AA-', given our assessment of Enexis' business risk profile as "excellent."

Our business risk profile assessment continues to reflect Enexis' natural monopoly status in its license areas, its low-risk regulated electricity and gas distribution network businesses, and its high-quality network assets. These strengths are partly offset by regulatory tariff reset risk every three years and the company's exposure to incentive-based regulation that can impose challenging efficiency requirements.

We consider that the draft method decision for the next regulatory period starting on Jan. 1, 2014, published by the regulatory Authority for Consumers and Market (ACM) on May 1, 2013, could be challenging for the Dutch distribution network operators. The draft method decision indicates that the

ACM could lower the real pretax weighted-average cost of capital to 3.6% from 6.2%, which we calculate would reduce Enexis' revenues by about 8% in 2014. However, we believe that Enexis' efforts to reduce costs and its prudent prefunding of upcoming debt maturities at a lower cost, as well as the fact that dividends are likely to reduce with lower net profit, could mitigate a challenging tariff set.

The "modest" financial risk profile reflects Enexis' stable and predictable operating cash flow during a regulatory period, but also its sizable capital expenditure (capex) program of about €400 million over 2013 and close to €1.5 billion during the next regulatory period 2014-2016.

Under our base-case scenario, we anticipate that Enexis' Standard & Poor's-adjusted FFO-to-debt ratio will fall to about 30% in 2013 from close to 36% in 2012. We expect credit metrics to decline further from 2014, but that the FFO-to-debt ratio will be about 26% in 2014 and 2015.

The 'AA-' rating on Enexis is based on the company's stand-alone credit profile, which Standard & Poor's assesses at 'aa-', and on our opinion that there is a "moderate" likelihood that Enexis' owners would provide timely and sufficient extraordinary support in the event of financial distress. In accordance with our criteria for government-related entities, our view of a "moderate" likelihood of extraordinary support is based on our assessment of Enexis':

- "Important" role, given Enexis' strategic importance to its province and municipality owners as the monopoly provider of gas and electricity distribution services in its license areas; and
- "Limited" link to its owners, given the dispersed ownership structure. Enexis' owners are the provinces of Noord Brabant (31%), Overijssel (19%), Limburg (16%), Groningen (6%), and Drenthe (2%), as well as other provinces and 116 municipalities in the region.

## Liquidity

We assess Enexis' liquidity position as "strong" as defined in our criteria, supported by our view that Enexis' liquidity sources will exceed its funding needs by over 1.5x in the next 12 months. Enexis' well-established and solid relationships with banks, generally high standing in the credit markets, and typically very prudent risk management, further support our opinion of liquidity as "strong."

As of June 30, 2013, we estimate that Enexis' liquidity sources over the next 12 months will exceed €1.6 billion under our base-case scenario. These include:

- Unrestricted cash and short-term marketable securities of close to €700 million.
- Access to an undrawn €450 million committed credit facility expiring in June 2015. We believe that Enexis will maintain substantial headroom under the financial covenants in its credit facility documentation.

- Annual FFO of about €490 million.

We estimate that Enexis' liquidity needs will exceed €1 billion in the 12 months to June 30, 2014, including:

- Working capital of about €5 million.
- Capex of about €430 million.
- Early redemption of a €500 million shareholder loan that falls due in September 2014.
- Dividend payments of about €115 million.

## Outlook

The stable outlook reflects our opinion that Enexis will be able to sustain adjusted FFO to debt of about 25%. Underpinning this opinion are our assumptions that we will continue to assess Enexis' business risk profile as excellent, and that the final determination for the 2014-2016 tariff will not be materially different from the draft determination that ACM published on May 1, 2013.

We could lower the ratings if we believe that the company is likely to recapitalize its balance sheet to maintain its publicly stated minimum requirement of FFO to debt of 20%. In our view, this could occur either through further sector consolidation in The Netherlands or an extraordinary dividend distribution. If the ACM's final tariff decision for the next regulatory period is worse for Enexis than that indicated in the draft method decision, that could also weaken the company's credit metrics.

Although we consider it unlikely, given the regulated tariffs through 2016, and the company's capex program and dividend policy, we could upgrade the ratings if we deemed it likely that Enexis would be able to sustain adjusted FFO to debt of about 35%, all else being equal.

## Related Criteria And Research


- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008

## Ratings List

Upgraded; CreditWatch/Outlook Action

| | To | From |
|---|---|---|
| Enexis Holding N.V. | | |
| Enexis B.V. | | |
| Corporate Credit Rating | AA-/Stable/-- | A+/Positive/-- |

Upgraded

| | To | From |
|---|---|---|
| Enexis Holding N.V. | | |
| Senior Unsecured | AA- | A+ |

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