S&P Global Ratings

RatingsDirect®

Ratings On Dutch DSOs Alliander And Enexis Holding Put On CreditWatch Negative; Ratings On Stedin Holding Affirmed

June 4, 2021

PRIMARY CREDIT ANALYSTS

Gerardo Leal
Frankfurt
+ 49 69 33 999 191
gerardo.leal@spglobal.com

Pauline Pasquier
Paris
+ 33 14 420 6771
pauline.pasquier@spglobal.com

SECONDARY CONTACTS

Claire Mauduit-Le Clercq
Paris
+ 33 14 420 7201
claire.mauduit@spglobal.com

Bjoern Schurich
Frankfurt
+ 49 693 399 9237
bjoern.schurich@spglobal.com

ADDITIONAL CONTACT

Industrial Ratings Europe
Corporate_Admin_London@spglobal.com

- On April 19, 2021, the Dutch regulator published the draft regulation for the 2022-2026 period, confirming significantly lower regulatory returns and adding pressure on distribution system operators' (DSOs) credit metrics over the medium term.
- In addition, we have more clarity on the potential financial impact and credit metric trajectory for our rated DSOs--Alliander N.V., Enexis Holding N.V., and Stedin Holding N.V.--over the next regulatory period resulting from the draft.
- We foresee a clear downward trajectory in credit metrics for our rated DSOs, but each player is reacting differently by implementing equity-like instruments that protect balance sheet to varying degrees.
- We placed on CreditWatch with negative implications our 'AA-/A-1+' long- and short-term issuer credit ratings (ICRs) on Alliander and our 'A+' long-term ICR on Enexis. At the same time, we affirmed our 'A-/A-2' ICRs on Stedin.
- The rating actions on Alliander and Enexis reflect our view that, in addition to the likely pressure on their credit metrics that should arise from a substantial increase in capital expenditure (capex), coupled with substantially lower regulatory returns, the companies have updated their financial policies to adapt to larger financing needs, which we believe will translate into higher leverage tolerance.
- The outlook on Stedin remains stable because of the company's firm commitment to protect an 'A-' rating and our expectation that Stedin will receive enough financial support from its shareholders in addition to other financial tools to protect the rating.

FRANKFURT (S&P Global Ratings) June 4, 2021--S&P Global Ratings today took the following rating actions:

- We placed our 'AA-/A-1+' long- and short-term ICRs on Alliander N.V. on CreditWatch with negative implications;
- We placed our 'A+' long-term ICR on Enexis Holding N.V. on CreditWatch with negative implications; and
- We affirmed our 'A-/A-2' ICRs, with a stable outlook, on Stedin Holding N.V.

The rating actions follow the publication of the draft method decision by the Dutch regulator, the Authority for Consumers and Markets (ACM), which will drive financial remuneration for our rated DSOs over the 2022-2026 regulatory period and our updated understanding of the financial implications for our rated DSOs. The main negative implication is a significant decline on the real weighted-average cost of capital (WACC) to 0.99% by the end of the regulatory period from 1.35% in 2021, which will be the base for electricity grid remuneration. This drop, coupled with the increasing capex needs to adapt the grid to new decentralized renewable power capacity, will put significant pressure on DSOs' credit metrics. We expect a yearly average investment in energy grids in the sector of €2.9 billion-€3.0 billion over the next regulatory period, which represents a 40%-50% increase from the sector's yearly investments in the previous regulatory period.

Despite the lower WACC, we still see the Dutch regulatory framework as very supportive. The WACC evolution follows lower interest rates but we see the formula as transparent and we still believe the operators will recover their investments in full. Moreover, we believe that the operators and the ACM have found solutions in favor of the financial stability of the sector in the past. The recovery of transmission costs now recovered immediately as opposed to a two-year lag before is a notable example. In addition, we believe remunerating the gas grids based on a nominal WACC and proposing to accelerate the depreciation rate of their assets provides more clarity for gas assets and could mitigate uncertainties regarding infrastructure use for the coming regulatory period in the context of the planned gas phase out in the Netherlands by 2050. Nevertheless, the energy transition in the Netherlands will require substantial investments until 2050, and the Dutch DSOs are seeking to find structural long-term solutions to broader financing challenges in the sector by opening dialogue with the central government and the ministry of economic affairs and climate policy, and the ministry of finance. We expect affordability will remain at the top of the agenda, even if we recognize that the Dutch regulatory framework has a track record of balancing customers', investors', and operators' interests to promote investment in long-term infrastructure. However, this is yet to be seen over the medium term. For now, we believe that significant investments coupled with lower returns are putting significant pressure on the sector's credit quality by straining the operators' financial metrics. We expect the DSOs to contest some aspects of the decision, although potential upsides are unclear. We expect the ACM to publish the final method decision in October 2021.

In anticipation to the financial challenges of the next regulatory period, the DSOs are establishing equity instruments and adapting their financial policies differently. We don't consider our three rated operators government-related entities, so we incorporate the shareholder's ongoing support from public entities into our forecasts and into the financial risk profile assessment of these operators' creditworthiness. We have no evidence that the support from shareholders is not a one-off intervention and that it can be enacted quickly in times of stress.

Alliander N.V.

A gradual-but-clear decline in credit metrics and updated financial policy result in our expectation that Alliander will be unable to maintain the 'AA-' rating. The company has built financial headroom, and we expect it will use it, potentially at the expense of the current rating. Despite the draft methodology resulting in a lesser decline in credit metrics than we anticipated, we expect gross capex increasing to about €1.2 billion per year from an average of €800 million over the 2016-2021 regulatory period, coupled with lower returns will result in credit metrics trending well below 23% by 2023. In addition, on May 31, 2021, Alliander adjusted its financial policy to allow for funds from operations (FFO) to debt of at least 15%. Therefore, despite Alliander keeping the 'A' minimum rating tolerance unchanged, we expect leverage to progressively increase enhancing risks of metrics not remaining consistent with the 'AA-' rating.

Although Alliander is updating its financial policy, we don't view the 'A' rating and 15% FFO to debt as a target. We expect the company to operate above the level dictated by its financial policy. Our opinion is based on its track record of operating significantly above FFO to debt of 20%, which until now was the company's financial policy.

We expect Alliander to remain the operator with the lowest leverage amid the Dutch DSOs over the medium term. The company will optimize its balance sheet in a way that it can fulfill its mandate within the Dutch energy transition by investing in its grid while preserving healthy credit quality. In this context, Alliander announced a €600 million reverse convertible shareholder loan when it amended its financial policy. We expect the company to receive the proceeds by December 2021. In our opinion, despite this likely being insufficient to maintain the 'AA-' rating, it would prevent Alliander's balance sheet from deteriorating further.

We treat the proposed fixed rate convertible shareholder loan as having intermediate equity content. The loan will be equal in ranking to the company's hybrid, subordinated to senior debt, and will rank only senior to common and preferred shares. Interest is indefinitely deferrable without triggering an event of default, and there are no features in the documentation that could discourage or materially delay deferral. In addition, the instrument is not callable until the first reset date of Dec. 15, 2031, 10 years after issuance. The proposed loan would mature Dec. 15, 2081.

Because we view the hybrid loan as having intermediate equity content, we will allocate 50% of the related payments on the security as a fixed charge and 50% as equivalent to a common dividend. The 50% treatment of principal and accrued interest also applies to our adjustment of debt. We expect Alliander's hybrid capital as percentage of total capitalization close to 15% upon the issuance of the convertible loan.

We believe the shareholder loan has strong qualitative features that would allow Alliander to preserve cash over the upcoming regulatory period, when the company will face a significant increase in capex needs. This is because the loan unilaterally converts to common shares in the event of a downgrade below the 'A' rating, which matches Alliander's updated financial policy. The instrument would also convert if a designated third-party forecasts the company's FFO to debt below 16% for 18 months from the calculation date, and there are no reasonable expectations that the metric will recover in the near term, although we understand this is not an unilateral conversion trigger. We expect Alliander's shareholders will participate in this loan pro rata, which in our view increases the likelihood that it is converted and adds to the instrument's equity features. By law, Dutch DSOs must be owned by a Dutch public entity. In addition, the instrument has no step-ups, which reduces incentives to redeem and enhances its permanence features. Instead, the interest rate is recalculated at teach reset date.

CreditWatch

The CreditWatch placement on Alliander reflects our view that an increase in investment to an average of €1.2 billion over the 2022-2026 period, from about €800 million over the 2016-2021 period, coupled with a material drop in regulated WACC for the electricity grids (which comprise most of Alliander's investment) will result in an FFO to debt trending significantly below 23% over the next regulatory period. The placement also reflects Alliander's updated financial policy, which adapts to the company's significant investment needs and allows for a minimum leverage tolerance to 15% of FFO to debt from 20% before. Alliander will likely receive support from its shareholders through a €600 million convertible hybrid loan. However, we believe this will be insufficient to maintain metrics at the rating level.

We would downgrade Alliander if, because of the final remuneration scheme and despite any remedial measures, we believe the company cannot sustain an FFO to debt above 23% over the next regulatory period. We will resolve the CreditWatch placement once the ACM publishes the final remuneration methodology for the 2022-2026 regulatory period, and we have calculated the final impact on Alliander's credit metrics.

We could revise the outlook to stable if the final framework for the next regulatory period allows for results more favorable than what we anticipate, resulting in our expectation that Alliander will post an FFO to debt sustainably above 23%.

Enexis Holding N.V.

The new remuneration scheme could affect Enexis' earnings such that it would fail to sustain FFO to debt above our 18% threshold for the rating from 2022. We believe that if the ACM proposal stands, with a clear cut in WACC despite the benefit from the acceleration of gas regulated asset base depreciation, the group would struggle to maintain its credit metrics for the next regulatory period. However, we will assess the final impact on Enexis' credit metrics following the final regulatory decision. The company is exposed to both electricity and gas regulatory parameters, the latter being under scrutiny as the Dutch regulatory policy follows a long-term planning of phasing out gas, which could trigger changes in remuneration.

A debt increase to finance a heavy capex plan will put additional pressure on metrics. The need for additional infrastructure amid the energy transition in the Netherlands raises Enexis' financing needs. Our expectation is that this investment will increase over the next two-to-three years reflecting an acceleration in infrastructure deployment to facilitate the energy transition. Smart metering deployment is still on target, with 85% of the total deployed.

The company's financial policy targets an FFO-to-debt ratio staying above 16%. We have seen some support from Enexis' shareholders, such as the €500 million shareholder loan issued in two tranches in 2020, for which we give intermediate equity credit (for more information, see "Enexis Holding N.V.'s Proposed Fixed-Rate Convertible Shareholder Loan Assigned Intermediate Equity Content," published April 17, 2020, on RatingsDirect). We expect the company's financial policy to continue in line with the 'A' rating. Despite some possible additional measures, like hybrid issuance or cost-cutting efforts, to protect Enexis' capital structure and credit metrics, we do not expect shareholders to provide a support that would be sufficient to maintain ratios in line with the 'A+' rating level.

CreditWatch

The CreditWatch placement on Enexis reflects our view that an increase in net investments to an average of €800 million over the 2022-2026 period, from about €640 million over the 2016-2021 period, coupled with an material drop in regulated WACC for the electricity grids (which cover most of the company's investment) will result in FFO to debt trending clearly below 18% over the next regulatory period. The placement also reflects Enexis' financial policy, which allows for a minimum leverage tolerance to 16% of FFO to debt.

We would downgrade Enexis if, following the final remuneration scheme and despite any remedial measures, we believe the company will not sustain an FFO to debt above 18% over the next regulatory period. We will resolve the CreditWatch placement once the ACM publishes the final remuneration methodology for the 2022-2026 regulatory period, and we have calculated the final impact on Enexis' credit metrics.

We could revise the outlook to stable if the final framework for the next regulatory period results are more favorable than what we anticipate, resulting in our expectation that the company posts FFO to debt sustainably above 18%.

Stedin Holding N.V.

Stedin has the lowest financial headroom of all DSOs, but has the strongest incentives to preserve the rating. The Dutch regulatory framework remunerates operators based on a regulated cost of debt calibrated for an issuer with an 'A' rating. This is to provide incentives to operators to preserve a healthy financial position, although the rating itself is not enforceable. We believe the company has strong incentives to protect the 'A-' rating, not only to cover its regulated costs, but also because of its incoming significant financing and refinancing needs.

A key difference between Stedin and its peers is a strong commitment to retaining an 'A-' rating, which is already lower than its peers. This means posting FFO to debt consistently above 11%. We view the group's unchanged financial policy as supportive and as a cornerstone of the 'A-' rating.

In addition to the rating commitment, we expect Stedin will make use of different instruments to protect its credit metrics over the next regulatory period. The company will need €700 million-€1 billion of additional equity to finance investment on its grid over the next decade. We expect equity support from Stedin's shareholders will cover a material part of these needs. For instance, the company will receive €200 million in the near term by issuing preferred shares. Because we treat this instrument as having 100% of equity content, we expect it will contribute to boost FFO to debt by about 70 basis points, resulting in a level above 11% at least until 2023. From then on, Stedin will require additional measures to preserve the 'A-' rating, and we believe the company has recourse to various protective balance sheet measures. For example, by exhausting Stedin's hybrid capacity or receiving more equity from its existing or new shareholders. This, along with a strong commitment to the 'A-' rating, explains our stable outlook on Stedin.

Outlook

The stable outlook captures our view that, despite significant lower regulatory returns over the 2022-2026 regulatory period, and that Stedin is the operator with the smallest headroom, the company will have enough shareholder support to preserve FFO to debt above 11% over the medium term. This mirrors Stedin's unchanged financial policy of preserving a minimum 'A-' rating, which we believe the company has strong incentives to comply with, as per the Dutch regulatory framework design. We believe Stedin will require additional capital to fund an average of €700 million in capex per year over the next regulatory period, but expect the company to have enough tools to maintain an FFO to debt of at least 11%, for example, by additional shareholder equity support, issuing new hybrid capital, or new capital.

We would downgrade Stedin if the remedial measures over the next regulatory period do not result in an FFO to debt sustainably above 11%. This could happen if shareholder support is less than what we foresee or upon an unfavorable regulatory development beyond what we capture in our base-case scenario.

We see little room for an upgrade in the medium term because of the significant pressure on Stedin's balance sheet.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

Ratings List

* * * * * * * * * * * * * * * Alliander N.V. * * * * * * * * * * * * * * *		
Ratings Placed on CreditWatch		
	To	**From**
Alliander N.V.		
Issuer Credit Rating	AA-/Watch Neg/A-1+	AA-/Stable/A-1+
Senior Unsecured	AA-/Watch Neg	AA-
Junior Subordinated	A/Watch Neg	A
*** * * * * * * * * * * * * * Enexis Holding N.V. * * * * * * * * * * * * ***		
Ratings Placed on CreditWatch		
	To	**From**
Enexis Holding N.V.		
Issuer Credit Rating	A+/Watch Neg/A-1	A+/Stable/A-1
Senior Unsecured	A+/Watch Neg	A+
Enexis Netbeheer B.V.		
Issuer Credit Rating	A+/Watch Neg/--	A+/Stable/--
*** * * * * * * * * * * * * * Stedin Holding N.V. * * * * * * * * * * * * ***		
Ratings Affirmed		
Stedin Holding N.V.		
Issuer Credit Rating	A-/Stable/A-2	A-/Stable/A-2
Senior Unsecured	A-	A-
Junior Subordinated	BBB	BBB
Commercial Paper	A-2	A-2
Stedin Netbeheer B.V.		
Issuer Credit Rating	A-/Stable/--	A-/Stable/--