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Enexis Holding N.V.

Primary Credit Analyst:
Nicole D Martin, London (1) 416-507-2560; nicole.martin@spglobal.com

Secondary Contact:
Beatrice de Taisne, CFA, London (44) 20-7176-3938; beatrice.de.taisne@spglobal.com

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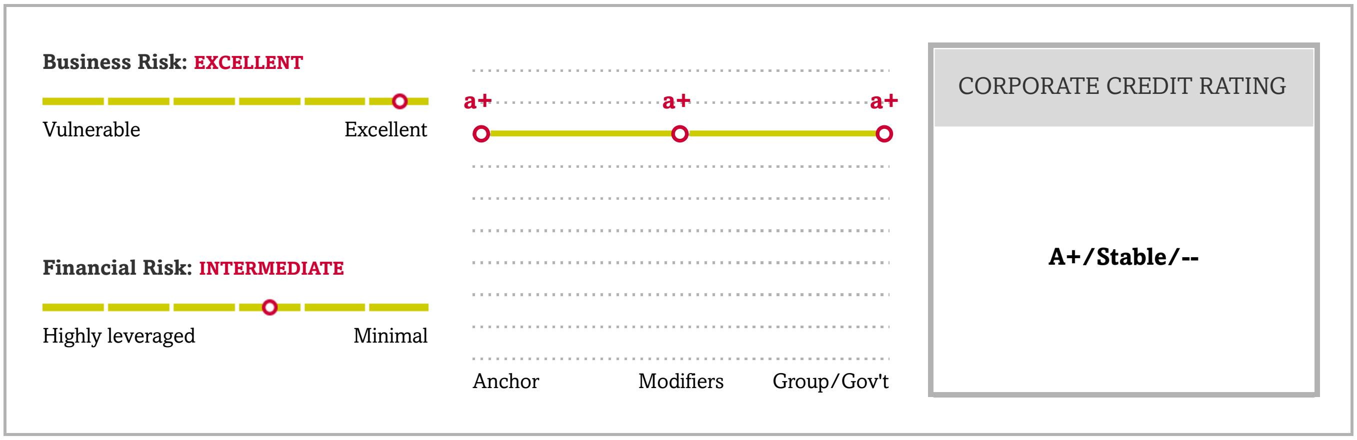

Rationale

Business Risk: Excellent	Financial Risk: Intermediate
• Monopoly owner and operator of regulated electricity and gas distribution regional networks in The Netherlands. • Predictable cash flow and earnings supported by transparent regulatory framework and low-risk business.	• Low allowed return on capital and high efficiency targets set by the regulator put pressure on revenues. • Cost of capital more aligned with regulatory assumptions used to set rates. • Prudent liquidity management.

Outlook: Stable

Our outlook on Dutch electricity and gas distribution network company Enexis Holding N.V. and on its subsidiary Enexis B.V. (jointly Enexis) is stable. We expect Enexis to sustain adjusted funds from operations (FFO) to debt of about 23%-24% in 2016-2018 as it continues to lower its cost of debt. This should mitigate the declining weighted-average cost of capital (WACC) used by the regulator to determine tariffs.

Downside scenario

We could lower the ratings if we expected FFO to debt to decline and remain below 18%. In our view, this is unlikely but could occur either through further distribution network consolidation or a debt-financed extraordinary dividend.

Upside scenario

We could raise the ratings if we deemed it likely that Enexis could sustain adjusted FFO to debt comfortably above 23% with no deterioration in business risk. This could result from an increase in return on capital allowed or a change in management's financial policy.

Our Base-Case Scenario

Assumptions

- Revenues increasing modestly in 2017 and 2018.
- Average EBITDA margin of about 50% over 2016-2019.
- Cumulative capital expenditure of about €600 million per year over 2016-2020 given the gradual rollout of smart meters.
- Dividend payments based on a 50% payout ratio.
- An allowed 4% regulatory WACC for 2017, declining to 3% by 2021.
- An average cost of debt of less than 3% over the next two years
- Customer connections continue to increase at a rate similar to the past five-year average.
- Assumed GDP growth for Netherlands of 1.7% in 2016 and just under 2% annually during 2017-2019.
- We have not included any further acquisitions or non-regulated investments in our forecast.

Key Metrics

	2015a	2016f	2017f
FFO/debt (%)	25.6	22-23	24
DCF/debt (%)	(1)	(5) to (7)	(5) to (7)
EBITDA margin (%)	52.2	50	50

FFO--Funds from operations. DCF--Discretionary cash flow. a--Actual. f--Forecast.

Business Risk: Excellent

Enexis benefits from a natural monopoly in its low-risk regulated electricity and gas distribution network businesses, and high-quality network assets. The company had total adjusted debt of €2.1 billion as of Dec. 31, 2015.

We view the regulatory framework as supportive and transparent. Enexis' revenues are determined by regulated tariffs that are set with cost recovery in mind. The utility is not exposed to commodity volume risk. There is a 15-year track record of successive regulatory cycles (recently lengthened to five years from three) with a consistent, published, and formula-based tariff setting methodology. The risk of privatization is minimal given the legal framework in place.

At the same time, the WACC (real pre-tax) allowed for in Enexis' tariffs remains among the lowest in Europe. Since 2014, when the allowed WACC was almost halved (to 3.5% from 6.2%) and FFO to debt fell to 25% in 2015 from 35% in 2014, management has been busy refinancing its debt (both public and shareholder loans). The company's debt costs are now more in line with market rates and the regulatory WACC, thus alleviating further pressure on FFO to debt during this current regulatory cycle (2017 to 2021). The tariffs also include ambitious efficiency targets that we think the company should be able to meet aided by synergies resulting from the 2015 asset swap with Alliander rationalizing its service territory and customer base.

Financial Risk: Intermediate

We expect Enexis' adjusted FFO to debt to be steady at around 22%-24% for 2016-2018 based on business as usual (no acquisitions). In our base case, discretionary cash flow to debt will be negative during this regulatory cycle given that the utility is mandated to roll out smart meters to all of it customers by 2020. The smart meter rollout is accelerating and we expect the company should be able to meet the target but it means that there is little flexibility in the level of capital spending for the next several years.

Although Enexis' cash flow leverage is close to our upside trigger of FFO to debt comfortably sustained above 23% (in line with its peers), we believe credit metrics will be challenged by further declining WACC after 2018 (to 3% by 2021 from 4% in 2017) and ongoing regulatory efficiency targets. In addition, our forecast does not include any further opportunistic acquisitions to rationalize its licensed territories (fill in the small gaps). We also believe that, given the very low returns being allowed by the regulator, management may be tempted to turn to riskier nonregulated activities in an effort to improve shareholder returns.

Liquidity: Strong

We view Enexis' liquidity as strong, supported by our view that liquidity sources will exceed funding needs by over 1.5x in the next 12 months.

Principal Liquidity Sources	Principal Liquidity Uses
We estimate that Enexis has liquidity sources over the next 12 months of about €1.25 billion, as of June 30, 2016, including: • Unrestricted cash and short-term marketable securities of close to €107 million. • Access to an undrawn €600 million committed credit facility expiring in June 2020. • Annual FFO of about €550 million.	For the same period, we estimate that liquidity uses will be €800 million, including: • Our estimate of about €600 million in fixed capex given smart meter rollout. • Debt maturities and dividend payments of almost €100 million each over the next 12 months.

Covenant Analysis

Enexis currently has no covenants on its debt or committed revolving credit facility.

Government Influence

As stipulated by the Dutch Independent Network Operation Act, electricity and gas distribution network operators in the Netherlands must be publicly owned. The 'A+' rating on Enexis is based on the company's stand-alone credit quality. Our view that there is a moderate likelihood that Enexis' owners would provide timely and sufficient extraordinary support in the event of financial distress does not impact the rating.

The moderate likelihood of support is based on our view of Enexis':

- Important role to the local governments, given Enexis' strategic importance to its provincial and municipal owners as the monopoly provider of gas and electricity distribution services; and
- Limited link to its many owners, given the dispersed ownership structure. Enexis' largest owners are the provinces of Noord Brabant (31%), Overijssel (19%), and Limburg (16%), as well as other provinces and 116 municipalities in the region.

Ratings Score Snapshot

Corporate Credit Rating

A+/Stable/--

Business risk: Excellent

- **Country risk:** Low
- **Industry risk:** Very low
- **Competitive position:** Excellent

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: a+

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : a+

- **Likelihood of government support:** Moderate (no impact)

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013

- Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related research

- State of The Netherlands 'AAA/A-1+' Ratings Affirmed; Outlook Stable, May 20, 2016

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	**a+/a**	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of October 19, 2016)

Enexis Holding N.V.	
Corporate Credit Rating	A+/Stable/--
Senior Unsecured	A+
Corporate Credit Ratings History	
06-Oct-2014	A+/Stable/--
15-Aug-2013	AA-/Stable/--
01-Nov-2011	A+/Positive/--
Related Entities	
Enexis B.V.	
Issuer Credit Rating	A+/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com