STANDARD & POOR'S

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Summary:
Enexis Holding N.V.

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Enexis Holding N.V.

Credit Rating: A/Stable/--

Rationale

The ratings on Dutch electricity and gas distribution network company Enexis Holding N.V. and its subsidiary Enexis B.V. (jointly Enexis) reflect Standard & Poor's Ratings Services' view of their low-risk regulated electricity and gas distribution network businesses, stable and predictable operating cash flow, high quality network assets, and stable operating performance. Enexis has a natural monopoly status in its license areas and the majority of its activities, including its electricity and gas tariffs, are regulated by the Dutch Ministry of Economic Affairs and the Dutch regulator, Energiekamer. Other unregulated businesses include infrastructure installation and maintenance activities, and account for less than 10% of Enexis' revenues.

The ratings are constrained by a sizable capital expenditures (capex) program in the medium term; and by the consolidation of the Dutch energy sector, which could entail further investments. Enexis is also exposed to the incentive-based regulatory framework in The Netherlands, and regulatory reset risk every third year. However, we note that, as we had anticipated, the regulator has reversed the efficiency factors in the current regulatory period from Jan. 1, 2011, thereby removing near-term reset risk.

The 'A' rating on Enexis is based on the company's stand-alone credit profile (SACP), which we assess at 'a', and on our opinion that there is a "moderate" likelihood that its owners would provide timely and sufficient extraordinary support in the event of financial distress.

In accordance with our criteria for government-related entities (GREs), our view of a "moderate" likelihood of extraordinary support is based on our assessment of Enexis':

- "Important" role, given its strategic importance to the province and municipality owners, as the monopoly provider of gas and electricity distribution services in its license areas; and
- "Limited" link to the 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 120 municipalities in the region.

Key business and profitability developments

In November 2010, Energiekamer announced the efficiency factors that would be applied to the Dutch electricity and gas distribution network operators for the regulatory period Jan. 1, 2011–Dec. 31, 2013. Enexis' efficiency factors are negative 6.2% (electricity) and negative 3.4% (gas), and result in a positive adjustment to Enexis' allowed tariffs. These compare with the 5.0% and 8.1% cost savings imposed on Enexis in the electricity and gas segments in the previous regulatory period.

We had expected that the regulator would reverse its cost savings requirements because the cost base in 2009 was higher than it had anticipated, and hence we have already factored in higher revenues and earnings in our projections. We foresee a reverse in the decrease in revenues and operating profits seen over the last two years (EBIT fell 5% in 2009 and 3% in the first half of 2010). In our opinion, it is likely that Enexis' EBITDA margin could increase to about 50% in the near term, from about 45% in 2009, and that its profitability could strengthen further to about 55% over the medium term.

Key cash flow and capital-structure developments

On Jan. 27, 2011, Enexis announced its intention to acquire a regional gas distribution network in the south of the Netherlands. The distribution networks, currently under the name of Intergas Energy, are situated in a region where Enexis already owns and operates the electricity distribution network and also part of the gas distribution network. We maintain our opinion that this investment would be relatively small--due to the limited size of the networks--and note that the acquisition price of about €200 million would be covered by the cash Enexis has accumulated on its balance sheet for acquisition purposes. Intergas Energy had a turnover of €30 million in 2009, and is small compared with Enexis, where turnover was €1.4 billion that year.

Enexis' regulated electricity and gas networks generate relatively stable and predictable operating cash flows, comfortably covering annual capex of about €450 million, on average, in the regulatory period through 2013.

Enexis' free operating cash flow increased in 2009, but we believe that its free operating cash flows after dividends are likely to have declined in 2010 and will remain low through 2013. We base this belief on our view that capex will gradually increase through the regulatory period, and on our understanding from management that dividend payments are likely to increase from 2011.

We believe that Enexis' adjusted funds from operations (FFO)-to-debt ratio is likely to fall in 2010, from over 23% in 2009, but that it will remain at about 20% in the medium term, thanks to improved profitability.

Liquidity

Enexis' liquidity position is adequate, in our view. This is due to its stable generation of cash flows, which in our opinion, in combination with substantial cash balances, will cover the acquisition of Intergas Energy, as well as capex and dividends through the next two years. Enexis has access to a fully undrawn €450 million committed bank line expiring in 2015. Enexis has no short-term debt.

Enexis' municipality owners provided a €1.8 billion shareholder loan to Enexis in September 2009, which the company used to repay an intercompany loan it had with the previous owner Essent N.V. (A/Negative/A-1).

The €1.8 billion shareholder loan is divided into four tranches of different sizes and maturities (due 2012, 2014, 2016, and 2019). The 10-year €350 million tranche contains an equity conversion element, triggered if Enexis risks breaching regulatory minimum credit metrics or covenants in its loan agreements. We understand that interest on the shareholder loan is nondeferrable, that the trigger levels are substantially below Enexis' expected credit metrics, and that Enexis intends to refinance the shareholder loan on the debt capital market when it falls due. We view the loan as debt in our analysis.

Outlook

The stable outlook reflects our opinion that Enexis will continue to generate solid free cash flows from its regulated business and will maintain an average ratio of FFO to debt of about 20%. A more aggressive financial policy than we anticipate (including a debt-financed acquisition or higher-than-anticipated dividends to the shareholders) or significant adverse regulatory changes, could put pressure on the ratings. The potential for a positive rating action is limited, in our view, owing to the sector consolidation that we expect Enexis to participate in, and given the company's sizable investment plan.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008

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