MOODY'S
INVESTORS SERVICE

Credit Opinion: Enexis Holding N.V.

Global Credit Research - 17 Sep 2010

Rosmalen, Netherlands

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating -Dom Curr	Aa3
Enexis B.V.	
Outlook	Stable
Issuer Rating -Dom Curr	Aa3

Contacts

Analyst	Phone
Richard Miratsky/Prague	420.224.222.929
Niel Bisset/London	44.20.7772.5454
Monica Merli/London	

Key Indicators

Enexis Holding N.V.

	Dec-2009	Dec-2008	Dec-2007
FFO Interest Coverage	**6.6x**	**2.9x**	**2.8x**
Net Debt / Fixed Assets	**37.9%**	**57.7%**	**76.1%**
FFO / Net Debt	**28.4%**	**13.9%**	**6.8%**
RCF / Capex	**1.6x**	**1.2x**	**1.5x**

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Corporate Profile

Enexis Holding N.V. (Enexis) is a holding company of Enexis B.V. that manages the distribution of gas and electricity in several Dutch regions and generates more than 90% of the group's revenue and represents 99% of group assets and liabilities. Enexis is fully owned by Dutch provinces and municipalities, with the largest owners being Noord Brabant (31%), Overijssel (19%), Limburg (16%), Groningen (6%) and Drenthe (2%). The remaining 26% share is owned by 1 other small province and approximately 120 small municipalities where Enexis provides its network services. Enexis is one of the three largest electricity and gas network operators in the Netherlands responsible for the maintenance, management and development of the medium-voltage electricity and gas distribution grids. During the unbundling process the respective distribution network, previously known as Essent Netwerk, was spun off from the Essent group and now operates independently under the name Enexis. It operates around 130,000 km of electricity cable and 40,000 km of gas pipelines, delivering electricity to approximately 2.6 million customers and gas to 1.9 million customers.

Recent Developments

Under the Independent Grid Management Act, adopted by the Dutch parliament in November 2006 and amended by the Royal Decree of 3 August 2007, the decision to proceed with the unbundling of Dutch electricity companies was taken. The unbundling requires the country's utilities to implement full legal and ownership separation of regulated network activities from commercial activities by 1 January 2011. Enexis has already finalised the process, operating as a fully legally and operationally independent entity since June 2009. Based on the case brought by some of the utilities in the Netherlands, The Hague Court of Appeal found provisions of the Dutch Electricity and Gas Act relating to the separation of companies' power production and network divisions to be in conflict with European law and, therefore, non-binding. Moody's perceives the ruling to be particularly pertinent to the two utilities that have yet to separate their network and energy production divisions. We expect Enexis's independent position and ownership structure to remain intact, as the court ruling should not have a direct impact on the already unbundled utilities, and the privatisation restrictions for network companies remain in place.

Rating Rationale

Given its 100% ownership by Dutch provinces and municipalities, Enexis falls within the scope of Moody's rating methodology for government-related issuers (GRIs) ("The Application of Joint Default Analysis to Government-Related Issuers, originally published in April 2005 and updated on 22 July 2010). In accordance with the methodology, Enexis's rating incorporates a two-notch uplift to its stand-alone credit assessment, which results from: (i) the credit quality of its owners; (i) level of potential support from its owners; and (i) default dependence (i.e. degree of exposure to common drivers of credit quality) between the company and its owners.

Moody's regards the credit quality of Enexis's shareholders as high, given their tight monitoring and supervision along with sufficient funding from the central government. We consider there to be a strong probability of systemic support in the event of financial distress, which reflects Enexis's strategic importance as a pure network company, and the high reputation risk to its owners. Although the ownership is relatively fragmented among approximately 125 provinces and municipalities, we perceive the shareholders to be capable and willing to act in conjunction with one another. In determining the probability of systemic support as strong, we have also taken into account the 72% ownership share of the four largest provinces and their historically proven ability to reach consensus in case of need. Moody's assessment of a very high level of dependence (i.e. degree of exposure to common drivers of credit quality) reflects our expectation that almost all of Enexis's revenues will continue to be derived from domestic sources, similarly to those of its owners.

Enexis's Baseline Credit Assessment (BCA) of 6 (on a scale of 1 to 21, where 1 represents the lowest risk and 6 is equivalent to an A2 rating), representing the company's credit quality before taking into account any support from owners, is characterised by the low risk of its domestic electricity and gas distribution operations, which generate more than 90% of its earnings and cash flows, supported by a well-defined, transparent and cost-efficient Dutch regulatory framework. The efficiency X and quality Q factors, applied to a Consumer Prices Index (CPI)-adjusted revenue cap, are based on an industry average mechanism that encourages companies to improve profitability by outperforming the industry through enhanced efficiency and increased quality. However, Moody's notes that the current focus of the regulatory regime on cost efficiency may limit the expected improvement in Enexis's financial profile in the medium term - especially during the execution of the company's capital investment programme, aimed at extending and maintaining its networks.

When assessing Enexis's BCA, Moody's applies its Rating Methodology for Regulated Electric and Gas Networks, published in August 2009, which identifies key areas of focus for assessing the relative fundamental credit quality of regulated electric and gas network companies. The methodology focuses on the assessment of the regulatory environment, ownership model, operational performance, stability of business model and key credit metrics. The BCA of 6 indicated by the methodology grid is based on historical financial performance and is in line with the assigned BCA. The strengthening of Enexis's capital structure by an equity injection and the company's significant leverage reduction in 2009 suggest a solid improvement in its debt protection metrics. However, we incorporated in our assessment following constraining factors: (i) the strong focus of the regulatory regime on efficiency gains; (ii) the company's increasing investment requirements; and (iii) the need to finance potential acquisitions, which may constrain Enexis's financial performance and limit any positive pressure on the BCA and rating in the medium term.

Rating Drivers

RATING FACTOR 1 - Regulatory Environment and Asset Ownership Model

Currently in its fourth regulatory period, the Dutch regulatory framework, applied since 2001, allows the country's electricity and gas distribution companies to earn a return on their regulated asset base, adjusted for consumer price index (CPI) and an efficiency incentive X factor. The regulation incorporates incentives based on a "yardstick" mechanism, which defines the efficiency X and quality Q factors based on industry averages and encourages network companies to improve profitability by outperforming the sector through improved efficiency and increased quality. The solid score (Aa) for the "Stability and Predictability of Regulatory Regime" sub-factor reflects the consistent application of transparent regulatory methodologies by the Dutch regulator. Although the tariff formula allows for the recovery of operating expenditures and a fair return on investments, the strong focus of the regulation on efficiency gains restricts Enexis's score for the "Cost and Investment Recovery" sub-factor to A.

The regulatory mechanism based on the revenue cap model and a gradual introduction of capacity-based payments reduces exposure of network companies to volume volatility risk, thus resulting in Enexis scoring Aa for the "Revenue Risk" sub-factor. Moody's assigns the same score to Enexis for the "Asset Ownership Model" sub-factor, given the company's full ownership of the network assets under a licence.

RATING FACTOR 2 - Efficiency and Execution Risk

Enexis's overall score for Factor 2 is supported by the high technical operating performance of Dutch networks, which is generally solid compared with European peers. Although Enexis has a low average annual outage time, reflecting the extremely high reliability of its network assets, the relatively higher X factor compared with the other main Dutch distribution network operators suggests Enexis needs to continue executing efficiency measures and consistently outperform industry measures applied by its regulator to support its financial performance. Enexis's annual investment plan, which is expected to gradually increase from its current level of EUR 300 million over the next five years, and the efficiency targets under the regulatory framework represent the company's main constraints within Factor 2, resulting in Baa scores.

RATING FACTOR 3 - Stability of Business Model and Financial Structure

With the exception of the public lighting and traffic management services, which have been separated into a joint venture with neighbouring distribution company Alliander (rated Aa3, stable) and do not exceed 10% of Enexis's revenues, the company strategically focuses on its core business of regulated activities based on its distribution network assets, resulting in a solid A score for the "Targeted Proportion of Profit outside Core Regulated Activities" sub-factor. Enexis's A score for the "Ability and Willingness to Pursue Opportunistic Corporate Activity" sub-factor might weaken over the time, as the company plans to play an active role in the long-term strategy for consolidation of the Dutch distribution network sector. Although the scope, timing and funding of Enexis's potential future acquisitions within the envisaged consolidation is not certain, the Baa score for the "Ability and Willingness to increase Leverage" sub-factor incorporates Moody's expectation that the company would need to increase its leverage to finance such acquisitions.

RATING FACTOR 4 - Key credit metrics

As a result of improved profitability and cash flow generation, positively influenced by the sale of high-voltage grid and reduced interest expenses, Enexis's credit metrics improved significantly. Enexis's capital structure strengthened due to the measures taken by the owners and management during the 2009 unbundling process, which represented: (i) a EUR 350 million equity injection by the owners; (ii) the use of proceeds from the sale of the company's high-voltage grid to the transmission operator TenneT TSO to decrease leverage; (iii) the favourable maturity of a EUR 1.8 billion long-term shareholder loan, with the possibility to convert the EUR 350 million tranche with the longest maturity into equity in case the minimum ratios required by the regulator are jeopardised; (iv) the successful arrangement of a EUR 450 million committed back-up revolving credit facility; and (v) the successful termination of the majority of the cross-border lease agreements (CBLs), eliminating potential financial exposure.

OTHER GRI FACTORS

Following unbundling, Enexis retained the same shareholding structure, - i.e. 100% ownership by a number of Dutch regional and local governments, with public ownership of the networks required by the current legislation. Therefore, Enexis is still considered a GRI under Moody's methodology. Moody's assumption of strong systemic support reflects Enexis's strategic importance as a pure network company, and the high reputation risk to its owners. Despite the relatively fragmented ownership structure of the company, we believe the support in extraordinary circumstances is likely to be coordinated by the larger shareholders. Furthermore, in Moody's view, the legal and political mechanisms established in Netherlands, including the legal requirement for public ownership of network assets, increase the probability of systemic support being provided to a strategically important network operator in the case of extraordinary need.

The very high level of default dependence reflects Enexis' significant exposure to the Dutch economy, with almost all of the company's revenues and cash flows generated from domestic activities resulting in a high level of exposure to common drivers of credit quality.

Liquidity Profile

As a result of prudent financial strategy the company's liquidity position and capital structure strengthened providing comfortable headroom under both the regulatory minimum ratio requirements and financial covenants included in the company's EUR 450 million back-up overdraft facility. The comfortable maturity profile on the shareholder loan, solid headroom under the overdraft facility and reasonable dividend policy that has been agreed - 30% by 2010 and 50% thereafter - further support the Enexis's solid liquidity position.

CROSS-BORDER LEASE AGREEMENTS

Enexis successfully managed to terminate most of its CBLs. These were signed on network assets by Enexis's predecessor and represented significant financial exposure in the event of early termination. Enexis's exposure to the remaining CBLs is currently at an immaterial level in relation to the company's size.

Structural Considerations

The shareholder loan, provided to Enexis Holding through a special-purpose vehicle (SPV), Vordering op Enexis B.V, which is fully owned by Enexis's shareholders, was on-lent to the operating company (Enexis B.V.) via an inter-company loan under essentially the same terms as the shareholder loan. Moody's understands that future bond issuances, aimed at refinancing the shareholder loan at maturity of its tranches, are planned at the Enexis Holding level with the proceeds to be on-lent to the operating company via a back-to-back intercompany loan in the same amount and with the same conditions and maturity as the bond issuance. Moody's also notes that Enexis's committed revolving overdraft facility, originally provided directly to the operating company (Enexis B.V.), has been renegotiated with a pool of local and international banks, scaled down to EUR 450 million and transferred to the Enexis Holding level. On the basis of these funding policies and actions, Moody's currently regards the risk of structural subordination for lenders at the holding level as low.

Rating Outlook

The stable outlook reflects Moody's expectation that Enexis will remain a pure electricity and gas distribution network operator that derives most of its revenues and cash flow from regulated activities. Furthermore, we expect Enexis to continue to follow its conservative financial policy, building on the successful developments of the unbundling process.

What Could Change the Rating - Up

Although the measures taken within the unbundling process improved Enexis's capital structure and strengthened its liquidity and debt protection metrics, the company would need to comfortably exceed, on a consistent and sustainable basis, the credit metrics set within its financial policy and incorporated in its business plan (a funds from operations (FFO)/interest coverage ratio above 4x and a FFO/net debt ratio above 20%) in order for positive pressure to be exerted on the rating.

What Could Change the Rating - Down

To remain safely positioned within its current BCA of 6, Moody's expects Enexis to exhibit on a sustainable basis the following minimum credit metrics: an FFO/interest coverage ratio at or above 3.5x and an FFO/net debt ratio above 15%. If the company's debt protection metrics decline substantially below these levels, mainly due to an increase in indebtedness above the forecast levels and/or weakening of cash flow generation, the BCA and rating might come under downward pressure.

Rating Factors

Enexis Holding N.V.

Unregulated Utilities	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1: Regulatory Environmnet and Asset Ownership Model (40%)							
a) Stability and Predictability of Regulatory Regime (15%)		x					
b) Asset Ownership Model (10%)		x					
c) Cost and Investment Recovery (Ability and Timeliness) (10%)			x				
d) Revenue Risk (5%)		x					
Factor 2: Efficiency and Execution Risk (10%)							
a) Cost Efficiency (6%)				x			
b) Scale and Complexity of Capital Programme (4%)				x			

Factor 3: Stability of Business Model and Financial Struct. (10%)							
a) Ability & Willingness to Pursue Opportunistic Activity (3%)			x				
b) Ability and Willingness to Increase Leverage (3%)				x			
c) Proportion of Operat. Profit outside Core Reg. Activities (3%)			x				
Factor 4: Key Credit Metrics (40%)							
a) Adjusted Interest Cover Ratio or FFO Interest Cover (15%)				x			
b) Net Debt / RAV (or Fixed Assets) (15%)			x				
c) FFO / Net Debt (5%)			x				
d) RCF / Capex (5%)				x			
Rating:							
a) Indicated Rating from Grid			**A2**				
b) Actual Rating (BCA) Assigned			**A2**				

Government-Related Issuer	Factor
a) Baseline Credit Assessment	6
b) Supporter Rating	Aaa
c) Default Dependence	Very High
d) Support	Strong