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Enexis Holding N.V.

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Enexis Holding N.V.

Major Rating Factors

Corporate Credit Rating
A/Stable/--

Strengths:

- Monopoly electricity and gas distribution networks in the company's license areas.
- Regulated revenues under transparent regulatory framework; limited non-regulated activities.
- Stable and predictable free cash flows from regulated businesses.

Weaknesses:

- Regulatory reset risk and exposure to incentive-based regulation.
- High efficiency targets set in current regulatory period through 2010.
- Sizable capex program; and longer-term potentially significant investments in smart meters.

Rationale

The ratings on Dutch distribution network company Enexis Holding N.V. and its subsidiary Enexis B.V. (jointly Enexis) reflect our view of its low-risk regulated electricity and gas distribution network business, stable and predictable operating cash flow, high quality network assets, and stable operating performance.

The ratings are constrained by an expected increase in Enexis' capital expenditures (capex) in the medium term, which may not be fully recovered through tariffs; and exposure to incentive-based regulation.

The province of Noord Brabant owns 31% of Enexis, Overijssel owns 19%, and Limburg 16%. The remainder is divided between other provinces and 140 municipalities in the region. The 'A' rating on Enexis is based on the company's stand-alone credit profile (SACP), which we assess at 'A', as well as 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), this view is based on Enexis' "important" role as the monopoly provider of gas and electricity distribution services in its license areas, and a "limited" link to the owners given the dispersed ownership structure.

Key business and profitability developments

Enexis has a natural monopoly in its license areas and a majority of its activities, including its electricity and gas tariffs, are regulated by the Dutch Ministry of Economic Affairs and the regulator, Energiekamer. The regulated nature of Enexis' activities implies that its earnings will generally be stable. However, we believe that the company's profitability could decline in 2010 due to the regulator's imposed efficiency requirements for the current regulatory period, 2008-2010. We estimate that Enexis' revenues will increase from 2011, based on a higher regulated asset value and lower efficiency factors. In combination with stable operating costs, this should result in improved profitability.

Key cash flow and capital-structure developments

Enexis' regulated electricity and gas networks generate stable and predictable operating cash flows, comfortably covering annual capex of about €250 million. The regulatory framework entails substantial investments in smart meters, but the program has been postponed beyond 2013. However, this adds uncertainty because it is not yet known whether the costs will be fully recovered through regulatory tariffs.

We believe that Enexis' adjusted funds from operations (FFO) to debt will be stable at about 20% over the medium term, and that its adjusted-debt-to-capital ratio will be stable at about 40%.

Liquidity

Enexis' liquidity position is strong, in our view, due to its stable generation of cash flows, which in our opinion will comfortably cover capex and dividends, and lack of short-term debt. Enexis has access to a fully undrawn €550 million committed bank line expiring 2012.

Enexis took over the ownership of its networks in 2007, funded with a €3.3 billion intercompany loan from the then owner Essent N.V. (A/Watch Neg/A-1). When Enexis was legally separated from Essent on June 30, 2009, Essent provided Enexis with a €350 million capital injection, as stipulated by the regulator in order to strengthen Enexis' capital structure. Enexis used these funds, and €350 million stemming from the sale of the high-voltage grid to the Dutch transmission system operator TenneT (not rated), to reduce the intercompany loan from then outstanding amount of €2.5 billion to €1.8 billion.

At the closing of RWE AG's (A/Negative/A-1) acquisition of Essent's unregulated generation and supply operations on Sept. 30, 2009, Enexis' owners provided a €1.8 billion shareholder loan to Enexis which the company used to repay the outstanding amount of the loan.

The €1.8 billion shareholder loan is divided into four tranches of different size and maturities (3, 5, 7, and 10 years). The 10-year €350 million tranche contains an equity conversion element, triggered if Enexis were to risk breaching regulatory minimum credit metrics or covenants in its loan agreements. However, we understand that interest is nondeferrable, that the trigger levels are substantially below Enexis' expected credit metrics, and that Enexis intends to refinance the shareholder loans on the debt capital market when they fall due, and we view the loans as debt in our analysis.

Outlook

The stable outlook reflects our belief 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 expected at Enexis (including a debt-financed acquisition or higher-than-expected 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, given the investments required to implement the regulatory smart meter model from 2013 and uncertainties as to its regulatory treatment.

Business Description

Enexis is the second largest distribution network company in The Netherlands. Its networks span 130,000 kilometers (km) of electricity cables and 41,000 km of gas pipelines, delivering electricity to about 2.6 million customers and gas to 1.9 million customers in its license areas.

Government Support And GRE Methodology Impact

The 'A' rating on Enexis is based on the company's (SACP), which we assess at 'A', as well as 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 GREs, our view is based on Enexis':

- "Important" role 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. The provinces of Noord Brabant, Overijssel and Limburg own 31%, 19%, and 16%, of Enexis, respectively, and the remainder is divided between other provinces and 140 municipalities in the region.

Business Risk Profile: Excellent, Due To Natural Monopoly And Regulated Revenues

The major supports for Enexis' "excellent" business risk profile are:

- Monopoly electricity and gas distribution networks in its license areas in the north east and south east of The Netherlands. There are currently nine regional network companies in The Netherlands, of which the three largest, Enexis, Alliander N.V. (A/Stable/A-1), and Eneco Holding N.V. (A-/Negative/A-2) account for 90% of the market.
- Regulated revenues under a transparent regulatory framework and limited non-regulated activities. Of Enexis B.V.'s total revenues, 90% are regulated: 63% electricity, 21% gas distribution, and 6% household metering. The remaining 10% comprises large-scale industrial metering. Enexis Holding's revenues comprise 90% from Enexis B.V. and 10% from services relating to public lighting, traffic management, and parking systems.

These supports are partially offset by:

- Regulatory reset risk and exposure to incentive-based regulation. The current regulatory period runs to 2010 and uncertainties relate to the next regulatory period from 2011. Enexis is exposed to the risk that the regulator imposes adverse changes to the regulatory framework or maintains the efficiency requirements at a high level. Uncertainties also include the introduction of the smart meter model. While the implementation of smart meters has been delayed, the smart meter model would eventually result in a fairly significant increase in capex.
- High efficiency targets set in the current regulatory period through 2010. The regulator imposed efficiency requirements (x-factors) of 5.0% in electricity and 8.1% in gas. This represented a significant increase from previous regulatory periods, but the levels are similar to the efficiency targets set for the company's Dutch peers. The regulator set the q-factor for Enexis at 0.2%. (The q-factor indicates the extent to which revenues can be raised based on quality supplied relative to a national average.)

Financial Risk Profile: Intermediate, Reflecting Solid Free Cash Flow And Stable Credit Metrics

The main strengths of Enexis' "intermediate" financial risk profile are:

- Stable and predictable free cash flows from regulated businesses. We anticipate that Enexis' earnings and cash flows will decline slightly in 2010 due to higher efficiency requirements. We believe, however, that the company's free cash flow will steadily improve between 2011 and 2013 due to higher allowed revenues based on higher regulated asset value and lower efficiency factors.
- Intermediate financial policy, including a dividend policy of 30% of net income in 2010 and 50% thereafter, and a policy to maintain leverage below 55% and FFO to debt at about 20%.
- Well spread maturity profile. The €1,800 million shareholder loan is divided into four tranches: €450 million due 2012, €500 million due 2014, €500 million due 2016, and €350 million due 2019. The 10-year tranche contains an equity conversion element, triggered if Enexis were to risk breaching regulatory minimum credit metrics or covenants in its loan agreements. However, we understand that interest is nondeferrable, that the trigger levels are substantially below Enexis' expected credit metrics, and that Enexis intends to refinance the shareholder loans on the debt capital market when they fall due, and we view the loans as debt in our analysis.

These strengths are moderated by:

- The company's sizable capex program and longer-term potentially significant investments in smart meters. Enexis' capex plan through 2013 contains maintenance capex, which accounts for about one-quarter of the plan, and expansion of the network accounts for about one-half of the investments. The remainder comprises connections and reconstruction of the networks, which are covered by connection charges or other third-party contributions.

Financial Statistics/Adjustments

Enexis reports under International Financial Reporting Standards. We adjust the financials for the 10-year tranche of the shareholder loan, which we treat as debt because interest payments are nondeferrable, the trigger levels for equity conversion is substantially below Enexis' expected credit metrics, and Enexis intends to refinance all the shareholder loans, including the 10-year €350 million tranche, on the debt capital market when they fall due.

Ratings Detail (As Of December 9, 2009)*	
Enexis Holding N.V.	
Corporate Credit Rating	A/Stable/--
Corporate Credit Ratings History	
09-Dec-2009	A/Stable/--
Business Risk Profile	Excellent
Financial Risk Profile	Intermediate

Ratings Detail (As Of December 9, 2009)***(cont.)**	
Debt Maturities	
On Sept. 30, 2009: 2010: Nil 2011: Nil 2012: €450 mil. 2013: Nil Thereafter: €1,350 mil.	
Related Entities	
Enexis B.V.	
Issuer Credit Rating	A/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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