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Enexis Holding N.V.

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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 nonregulated activities.
- Stable and predictable cash flows from regulated businesses.

Weaknesses:

- Sizable capital expenditure program; potentially significant investments in smart meters over the longer term.
- Regulatory reset risk and exposure to incentive-based regulation.

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 low-risk regulated electricity and gas distribution network businesses, stable and predictable operating cash flow, high quality network assets, and stable operating performance.

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, although we note that the regulator, Energiekamer, recently announced that tariffs would likely increase from Jan. 1, 2011, thereby reducing near-term reset risk.

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 Energiekamer. Other unregulated businesses include infrastructure installation and maintenance activities, and account for less than 10% of Enexis' revenues.

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 approximately 120 municipalities in the region.

Key business and profitability developments

Enexis reported a 1% decrease in revenues in 2009, while operating profits (EBIT) fell 5% (excluding one-off items relating to the unbundling). This trend continued in the first half of 2010, with operating profits 3% lower than in the same period of 2009. From 2011, however, we estimate that Enexis will boost its revenues and earnings, thanks to an increase of tariffs and a higher regulated asset value. In combination with stable operating costs, we think that this should result in improved profitability.

Key cash flow and capital-structure developments

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 next 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 decline in 2010 and remain low through 2013. We base this view on our expectations that capex will gradually increase through the regulatory period, and on our understanding that dividend payments are likely to increase from 2011. In addition, we note that the consolidation of the Dutch distribution network sector could entail investments on Enexis' part. However, our opinion is that these investments should be relatively small--due to the limited size of the networks--and that a larger acquisition would likely be supported by the shareholders, given their commitment to Enexis' financial policies. 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 recovered through regulatory tariffs.

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 combination with substantial cash balances, will cover capex and dividends through the next two years, in our opinion. 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 (three, five, seven, and 10 years). 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 loans 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 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-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, owing to the sector consolidation that we expect Enexis to participate in, and given the company's sizable investment plan.

Business Description

Enexis is the second largest distribution network company in State of The Netherlands (AAA/Stable/A-1+) with a market share of about 30%. 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. The vast majority of customers are residential, while industrial customers number about 24,000.

Government Support And GRE Methodology Impact

In accordance with our criteria for GREs, the 'A' rating on Enexis is based on the company's 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.

We view Enexis' role as "important" for the province and municipality owners because it provides essential public services to the population of its service areas. Enexis owns the electricity and gas meters of every household in the operating region and is the monopoly provider of gas and electricity distribution services. We assess Enexis' link to the owners as "limited" because of the dispersed ownership structure. As stipulated by the Dutch Independent Network Operation Act, electricity and gas distribution network operators in The Netherlands must be publicly owned. Enexis' owners are the provinces of Noord Brabant (31%), Overijssel (19%), Limburg (16%), Groningen (6%), and Drenthe (2%), as well as approximately 120 municipalities in the region. We understand that shareholder interests are represented through a shareholder committee, which has seven members representing the four largest provinces as well as a representative each for the municipalities in the northern part of The Netherlands, Limburg, and Brabant.

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 Stedin (part of Eneco Holding N.V. [A-/Negative/A-2]) account for 90% of the market.
- Regulated revenues under a transparent regulatory framework and limited nonregulated 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.

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. However, we understand that the efficiency measures will ease in the next regulatory period from Jan. 1, 2011, and that, on average, tariffs would increase by 5%-7% for the gas and electricity distribution businesses. At the same time, gas connections would become regulated. While we believe that this would add to the stability of earnings and cash flow generation, the regulated tariffs are likely to be lower than current connection charges and so lead to a slight reduction in revenues. Overall, we believe that total revenues could increase by 2% on average annually through 2013.

- Uncertainties remaining about the introduction of the smart meter model, whereby all households in The Netherlands would be fitted with a gas or electricity meter. While the mandatory implementation of smart meters has been postponed, voluntary installation of smart meters could eventually result in a fairly significant increase in capex.

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 operating cash flow will steadily improve between 2011 and 2013, due to higher allowed revenues based on higher regulated asset value and lower efficiency factors.
- Its 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%.
- Its well-spread maturity profile. The €1,800 million shareholder loan is divided into four tranches due between 2012 and 2019. The 10-year bond contains an equity conversion element, triggered if Enexis breaches 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:

- Enexis' sizable capex program and, longer-term, potentially significant investments in smart meters. Enexis' capex plan through 2013 amounts to about €1.8 billion. Maintenance capex accounts for about one-quarter of the plan, and expansion of the network accounts for about one-half of the investments. The remainder comprises IT, installation of smart meters, and other infrastructure-related products.
- Enexis' capex program, which would, in our view, result in a decrease in free cash flows in 2010 and 2011, and low free cash flows thereafter. Enexis' discretionary cash flow would be negative through 2013, and we therefore anticipate a slight increase in leverage, to about 41% by the end of the next regulatory period, from 40% in 2009.

Financial Statistics/Adjustments

Enexis reports under International Financial Reporting Standards. We make limited adjustments to Enexis' reported figures (see table 1).

Table 1

Reconciliation Of Enexis Holding N.V. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)*

	--Fiscal year ended Dec. 31, 2009--				
Enexis Holding N.V. reported amounts					
	Revenues	**Operating income (before D&A)**	**Operating income (before D&A)**	**Operating income (after D&A)**	**Cash flow from operations**
Reported	1,358.1	628.2	628.2	399.1	501.0
Standard & Poor's adjustments					
Reclassification of nonoperating income (expenses)	--	--	--	24.7	--
Reclassification of working capital cash flow changes	--	--	--	--	(47.3)
One-off items, relating to the unbundling	(29.0)	(21.2)	(21.2)	(21.2)	--
Total adjustments	(29.0)	(21.2)	(21.2)	3.5	(47.3)
Standard & Poor's adjusted amounts					
	Revenues	**Operating income (before D&A)**	**EBITDA**	**EBIT**	**Funds from operations**
Adjusted	1,329.1	583.4	583.4	379.0	453.7

*Enexis Holding N.V. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts. D&A--Depreciation and amortization.

Table 2

Enexis Holding N.V. Peer Comparison*

	Enexis Holding N.V.	**Alliander N.V.§**	**Northern Gas Networks Holdings Ltd.¶**	**CE Electric U.K. Funding Co.¶§**
Ratings on Sept 28, 2010	A/Stable/--	A/Stable/A-1	BBB+/Negative/--	BBB+/Stable/A-2
(Mil. €)	--Fiscal year ended Dec. 31, 2009--			
Revenues	1,329.1	1,446.0	386.6	637.5
Net income from continuing operations	263.1	312.0	11.3	119.2
Funds from operations (FFO)	453.7	487.8	124.2	281.0
Capital expenditures (capex)	299.6	296.0	109.8	289.6
Cash and short-term investments	192.2	0.0	1.7	6.8
Debt	1,926.5	1,440.9	1,193.2	1,958.1
Equity	2,849.1	2,245.0	346.2	773.2
Debt and equity	4,775.6	3,685.9	1,539.4	2,731.3
Adjusted ratios				
EBIT interest coverage (x)	4.3	2.3	2.1	2.5
FFO interest coverage (x)	5.9	3.9	2.6	3.3

Table 2

Enexis Holding N.V. Peer Comparison* (cont.)

FFO/debt (%)	23.6	33.9	10.4	14.4
Discretionary cash flow/debt (%)	10.5	(8.0)	(2.3)	(0.8)
Net cash flow/capex (%)	151.4	46.6	82.5	97.6
Total debt/debt plus equity (%)	40.3	39.1	77.5	71.7
Return on common equity (%)	10.3	16.0	2.6	13.4
Common dividend payout ratio (unadjusted; %)	30.0	17.3	298.7	0.0

*Fully adjusted. ¶Fully adjusted (including postretirement obligations). §Excess cash and investments netted against debt.

Table 3

Enexis Holding N.V. Financial Summary*

	--Fiscal year ended Dec. 31--	
(Mil. €)	**2009**	**2008**
Rating history	A/Stable/--	-/-/-
Revenues	1,329.1	1,341.9
Net income from continuing operations	263.1	147.5
Funds from operations (FFO)	453.7	276.4
Capital expenditures (capex)	299.6	302.3
Cash and short-term investments	192.2	2.0
Debt	1,926.5	2,613.0
Equity	2,849.1	2,236.0
Debt and equity	4,775.6	4,849.0
Adjusted ratios		
EBIT interest coverage (x)	4.6	2.2
FFO interest coverage (x)	5.9	2.4
FFO/debt (%)	23.6	10.6
Discretionary cash flow/debt (%)	10.5	7.0
Net cash flow/capex (%)	151.4	91.4
Debt/debt and equity (%)	40.3	53.9
Return on common equity (%)	10.3	7.9
Common dividend payout ratio (unadjusted; %)	30.0	0.0

*Fully adjusted.

Related Criteria And Research

- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009
- 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

Ratings Detail (As Of September 28, 2010)*	
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
Debt Maturities	
On Dec. 31, 2009: 2010: Nil. 2011: Nil. 2012: €450 mil. 2013: Nil. Thereafter: €1.35 bil.	
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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