Moody's Investors Service

Credit Opinion: Enexis Holding N.V.

Global Credit Research - 09 Dec 2009

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-2008	Dec-2007
FFO Interest Coverage	**2.9x**	**2.8x**
Net Debt / Fixed Assets	**57,7%**	**76,1%**
FFO / Net Debt	**13,9%**	**6,8%**
RCF / Capex	**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 over 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 approximately 140 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 (see details below) the respective distribution network, previously known as Essent Netwerk, has been spun off from the Essent group and since 1 January 2009 operates independently under a new name Enexis. It operates around 130,000 km of electricity cables and 40,000 km of gas pipelines, delivering electricity to approximately 2.6 million customers and gas to 1.9 million customers.

Recent Developments

Following a protracted debate in the Dutch parliament that lasted several years, the Dutch parliament finally adopted the Independent Grid Management Act in November 2006, which was further amended by the Royal Decree of 3 August 2007. Under the Royal Decree, the decision to proceed with the unbundling of Dutch companies was taken. Unbundling requires the country's utilities to implement full legal and ownership separation of regulated network activities from commercial activities. The utilities have until 1 January 2011 to complete the process. Enexis has already finalised the process, operating as a fully legally and operationally independent entity since June 2009, with the rest of the Essent group comprising of unregulated activities sold to the German utility group RWE in September 2009. Enexis has fulfilled all the unbundling prerequisites agreed with the regulator and Ministry of Economy, including (i) the successful negotiation of an equity injection by the shareholders and (ii) the provision of a shareholders' loan to refinance the former intra-company loan with the possibility to convert the EUR350 million tranche with the longest maturity into equity in case the minimum ratios required by the regulator are jeopardised. To further strengthen its liquidity position and capital structure, Enexis successfully managed to arrange a new back-up overdraft facility and decided to use the proceeds from the sale of its high voltage grid to TenneT TSO to further decrease its leverage.

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). Although the ownership is relatively fragmented among approximately 140 provinces and municipalities, Moody's perceives the shareholders to be capable and willing to act in conjunction with one another. Furthermore, the 72% ownership share of the four largest provinces and historically proven ability to reach consensus provides Moody's with comfort for the assignment of a medium level of expected systemic support to Enexis in case of a distressed situation. In accordance with the methodology, Enexis' rating incorporates uplift for potential support from its owners to its standalone credit quality. This is expressed by Moody's as a 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). The two-notch differential between the BCA and Moody's assigned rating results from the credit quality of the company's shareholders and Moody's assessment of a medium level of probability of systemic support in the event of financial distress, as well as medium default dependence (i.e. degree of exposure to common drivers of credit quality).

Enexis' BCA of 6, 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 over 90% of the group's earnings and cash flows, supported by a well defined, transparent and cost efficient-oriented Dutch regulatory framework. The inflation and efficiency gain (CPI-X) adjusted revenue cap-based regulation eliminates exposure to volume risk, providing a stabilising factor to Enexis' financial performance. However, Moody's notes that the current focus of the regulatory regime on cost efficiency may limit the expected improvement in Enexis' financial profile in the medium term, as the capital investment programme, aimed at extending and maintaining its networks, is executed.

In assessing Enexis' BCA, Moody's has incorporated the expected positive impact of the measures taken by the owners and management during the 2009 unbundling process. As a result the capital structure and liquidity position of the company significantly strengthened, mainly due to: (i) a EUR350 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 the EUR1800 million long-term shareholder loan, with the possibility to convert the EUR350 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 EUR550 million back-up revolving credit facility; and (v) the successful termination of the majority of the cross-border lease agreements, eliminating potential financial exposure.

When assessing Enexis' BCA, Moody's applies its Rating Methodology for Regulated Electric and Gas Networks, 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, financial policy and key credit metrics; it indicates, based on historical financial performance, a BCA of 6. Although Enexis' capital structure strengthened through an equity injection and a significant leverage decrease in 2009, suggesting solid improvement of debt protection metrics, Moody's incorporates in its assessment the strongly efficiency-focused regulatory regime and growing investment plans, which might constrain Enexis' financial performance in the medium term as well as the fulfilment of the relatively ambitious target ratios newly set within Enexis' financial policy.

Rating Drivers

RATING FACTOR 1 - Regulatory environment and asset ownership model

The regulatory framework for network companies, applied in the Netherlands since 2001, allows them to earn a return on their regulated asset base, adjusted for CPI and an efficiency incentive X factor. Regulation, now in its fourth period (2008-10), has incentives for the electricity and gas network companies, based on a "yardstick" mechanism, which defines the efficiency X and quality Q factors based on industry averages and encourages companies to improve profitability by outperforming the sector through improved efficiency and increased quality. The solid score (Aa) within the "Stability and Predictability of Regulatory Regime" sub-factor reflects consistent application of transparent regulatory methodologies by the Dutch regulator. Although the tariff formula allows for recovery of operating expenditures and a fair return on investments, the strong focus of the regulation on efficiency gains restricts the score under the "Cost and Investment Recovery" sub-factor to A.

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

RATING FACTOR 2 - Efficiency and execution risk

The overall score within Factor 2 is supported by the high technical operating performance of Dutch networks, which is generally very solid in the context of the 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 to other main Dutch distribution network operators suggests that Enexis could improve in certain areas, specifically in cost efficiency. Together with the annual investment plan that is expected to gradually increase from its current EUR300 million level over the next five years, the efficiency targets represent the main constraint within Factor 2 resulting in Baa scores.

RATING FACTOR 3 - Stability of business model and financial structure

With exception of the public lighting and traffic management services, which do not exceed 10% of revenues, Enexis strategically focuses on its core business of regulated activities based on its distribution network assets. Together with no major acquisitions planned within its strategy, Enexis scores solid A within the sub-factors "Opportunistic Corporate Activity" and "Proportion of Activities Outside the Core Network Segment".

Although the regulatory minimum financial ratios limit the scope of the potential increase in leverage for Enexis, the Baa score within the "Ability and Willingness to increase Leverage" sub-factor reflects Moody's perception that the minimum levels required by the regulator would be commensurate with significantly higher leverage than targeted by the company and factored into the rating.

RATING FACTOR 4 - Key credit metrics

Based on historical financials, the methodology indicates a 6 (A2-equivalent) level for Enexis' BCA. Although Enexis' capital structure has strengthened due to an equity injection and significant leverage decrease in 2009, suggesting solid improvement of debt protection metrics and a one-notch improvement in the indicated BCA (to 5 from 6), Moody's incorporates in its assessment the strong focus of the regulatory regime on efficiency gains and the growing investment requirements, which might constrain Enexis' financial performance in the medium term.

OTHER GRI FACTORS

Enexis retained the same shareholding structure after unbundling - 100% ownership by a number of Dutch regional and local governments, and public ownership of the networks is required by the current legislation, therefore is still considered a GRI under Moody's methodology. The medium level of systemic support reflects Enexis' strategic importance as a pure network company, and the high reputation risk to its owners. Despite the relatively fragmented ownership structure, Moody's believes the support in extraordinary circumstances is likely to be coordinated by the large owners. Furthermore, the medium level of support incorporates Moody's view that the legal and political mechanisms established in Netherlands, including the legal requirement of public ownership of network assets, increases the probability of systemic support to strategically important network operator in case of extraordinary need.

The medium level of default dependence reflects Enexis' significant exposure to the Dutch economy, as almost all revenues and cash flows are generated from domestic activities and through a high level of correlation to common drivers of credit quality.

Liquidity Profile

The capital structure and associated liquidity position of the company has been significantly strengthened within the unbundling process, as the shareholders provided an additional equity injection in the amount of EUR350 million and agreed to use proceeds from successful sale of the HV grid to TenneT TSO (EUR350 million) to reduce indebtedness. As a result of such prudent financial strategy, Enexis gained a very solid capital structure, providing comfortable headroom under both the regulatory minimum ratio requirements and financial covenants included in the EUR550 million back-up overdraft facility. The company plans to keep its indebtedness level stable over the medium term, as both capex and dividends are expected to be covered from own-generated sources. The dividend policy that has been agreed, at the level of 30% by 2010 and 50% thereafter, further supports the solid capital structure.

CROSS-BORDER LEASE AGREEMENTS

Enexis successfully managed to terminate most of the cross-border lease agreements (CBLs), signed on the network assets by the predecessor company, which represented significant financial exposure in case of early termination. Exposure from the remaining CBLs is currently at an immaterial level in relation to Enexis' size.

Structural Considerations

The structure of the shareholder loan, provided to Enexis Holding through an SPV, fully owned by Enexis' shareholders, was on-lent to the operating company (Enexis B.V.) via an intra-company loan under substantially and materially the same terms as the shareholder loan. Although the EUR550 million revolving overdraft facility arranged with a pool of local and international banks is provided directly to the operating company (Enexis B.V.), and future bond issuances, aimed at refinancing the shareholder loans at maturity, are planned at the Enexis Holding level, Moody's does not notch down Enexis' rating for structural subordination. Moody's expects the currently un-drawn overdraft loan to be utilised mainly as a back-up facility to balance seasonal swings in working capital needs. Furthermore, Moody's expects the intra-company loan between the holding company and the subsidiary to remain an integral part of the group's policy. However, if additional external financing were to be arranged in the future directly at the Enexis B.V. level, without suitably mitigating arrangements, which Moody's understands is not the management's intention, Moody's view on structural subordination would need to be reconsidered.

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, Moody's expects Enexis to continue to follow its conservative financial policy, building on the successful developments of the unbundling process.

What Could Change the Rating - Up

As the measures taken within the unbundling process are expected to improve Enexis' capital structure and strengthen its liquidity and debt protection metrics, the current rating of Enexis might come under positive pressure, especially if the credit metrics, set by Enexis within its financial policy and incorporated in its business plan (FFO Interest coverage above 4x and FFO/Net Debt above 20%), were to be comfortably exceeded on a consistent and sustainable basis.

What Could Change the Rating - Down

To be safely positioned within its current BCA of 6, Moody's expects Enexis to exhibit the following minimum credit metrics: FFO Interest coverage at or above 3.5x and FFO/Net Debt above 15% on a sustainable basis. If the debt protection metrics decline substantially below these levels, mainly due to a significant 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) Methodology Implied BCA			**A2**				
b) Actual BCA			**A2**				

Moody's Investors Service