MOODY'S
INVESTORS SERVICE

Credit Opinion: Enexis Holding N.V.

Global Credit Research - 01 Aug 2014

Rosmalen, Netherlands

Ratings

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

Contacts

Analyst	Phone
Stefanie Voelz/London	44.20.7772.5454
Andrew Blease/London	

Key Indicators

[1]**Enexis Holding N.V.**

	12/31/2013	12/31/2012	12/31/2011	12/31/2010	12/31/2009
(FFO + Interest) / Interest Expense	5.5x	6.4x	6.5x	5.3x	8.2x
Net Debt / Fixed Assets	31.4%	33.3%	31.6%	33.5%	37.3%
FFO / Net Debt	30.5%	30.5%	32.8%	25.5%	33.1%
RCF / CAPEX	0.9x	0.9x	1.1x	1.0x	1.4x

[1] All ratios are calculated using Moody's Standard Adjustments. Source: Moody's Financial Metrics TM

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

Opinion

Rating Drivers

- Low business risk underpinned by stable regulated cash flows; limited contribution from unregulated businesses

- Established regulatory framework, but allowed returns will reduce

- Two notches of rating uplift for potential support from government shareholders

Corporate Profile

Enexis Holding N.V. is a holding company of Enexis B.V., which owns and manages the gas and electricity distribution networks in several Dutch regions. Enexis B.V. generates more than 95% of the group's revenue and represents 99% of group assets and liabilities. Moody's rates both Enexis Holding N.V. and Enexis B.V. (together "Enexis"), both having ratings of Aa3 stable. Enexis is one of the three largest electricity and gas network operators in the Netherlands responsible for the maintenance, management and development of the mediumvoltage electricity and gas distribution grids. It operates around 136,000 km of electricity cable and 45,000 km of gas pipelines, delivering electricity to approximately 2.6 million customers and gas to 2.1 million customers. 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 one other small province and approximately 120 municipalities where Enexis provides its network services.

SUMMARY RATING RATIONALE

Enexis's Aa3 rating is characterised by the business 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 and transparent Dutch regulatory framework. The company has historically maintained a conservative financial position relative to European peers. However, we anticipate some decline in the current regulatory period, as allowed returns will reduce.

The rating incorporates a two-notch uplift to reflect the likelihood of extraordinary support being provided by its owners, and ultimately the Dutch government, to avoid a default if this were ever required.

DETAILED RATING CONSIDERATIONS

LOW BUSINESS RISK UNDERPINNED BY REGULATED CASHFLOWS

Enexis' core business activities relate to low risk regulated network operation and management. These activities generate predictable cash flows over the medium term, providing useful visibility on funding requirements.

Enexis's business is focused on the core regulated network activities, with a few exceptions that earn less than 10% of revenues in aggregate: Fudura energy services; public lighting and traffic management services as a joint venture with neighbouring network owner Alliander (Aa3 stable). We note that these non-regulated business are materially complementary to the core activities.

Enexis's internal investment plan does not present a challenge in terms of scale or growth ambitions. Capital expenditure - net of customer contributions - declined 4.5% to EUR398 million in 2013, but is expected to gradually increase over the current regulatory period. Future investment will be impacted by a proposed asset swap with Alliander. The potential transaction should allow the two businesses to better align some of their regional operations between both electricity and gas networks - where currently they each operate one network type in the same region.

ESTABLISHED REGULATORY FRAMEWORK BUT ALLOWED RETURNS WILL REDUCE

The Dutch framework applied since 2001 and 2004 for electricity and gas networks, respectivley, allows the country's distribution companies to earn a return on their regulated asset base, adjusted for a 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. This approach is typical of peer regulatory regimes in Europe and we consider that the application of the Dutch regulatory methodologies by the regulator, the Authority for Consumers and Markets (ACM), has been transparent and consistent to date.

The current price control period runs from January 2014 to December 2016 and allowed revenues have generally been tightened from those applied during the previous period. Most notably, the weighted average cost of capital (WACC) for network companies will be reduced to 3.6% (pre-tax) in real terms by the end of 2016, from a level of 6.2% previously.

While this new settlement will drive a material decline in allowed returns, Enexis has demonstrated its ability to operate within the bounds of the regulatory return allowance, and to fund comfortably within the cost of debt implied by the return calculation. For three years, Enexis has implemented tariff increases below the maximum allowed; the associated decline in returns under the new allowance will therefore impact Enexis to a lesser extent than its peers. We estimate Enexis' cost of external debt to be lower than the ACM's cost of debt assumption within the allowed return calculations, illustrating Enexis's ability to fund itself within the current regulatory allowances.

Furthermore, the regulator has imposed a series of cost efficiency targets on the networks (the `X-factor'), of around 5% for electricity and 7% for gas annually for Enexis, which will result in an incremental decline in the element of revenue funding of operating costs. Although the base costs have been reset on the basis of average costs in the period 2010-2012, we expect this to be a challenging target to outperform over the price control period.

TWO NOTCHES OF RATING UPLIFT FOR POTENTIAL SUPPORT FROM GOVERNMENT SHAREHOLDERS

Enexis is fully owned by Dutch regional and local governments, with public ownership of the networks required by current legislation. Therefore, in assessing Enexis's credit quality, we apply our rating methodology for Government-Related Issuers published in July 2010. Our assumption of strong systemic support in the event of need reflects Enexis's strategic importance as a pure network company, and the high reputation risk to its owners. Although ownership of Enexis 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 event of need. Furthermore, in our view, the legal and political mechanisms established in the Netherlands, including the legal requirement for public ownership of distribution network assets, increase the probability of systemic support by the Dutch Government being provided to a strategically important network operator in the event of extraordinary need.

Our assessment of a very high level of dependence (i.e. the degree of exposure to common drivers of credit quality) between Enexis and the Government of the Netherlands reflects our expectation that Enexis, like its owners, will continue to derive almost all of its revenues from domestic sources.

These factors support our assessment of two notches of rating uplift from a baseline credit assessment (BCA) of a2.

Liquidity Profile

Enexis's liquidity position has historically been supported by strong cash flow generation and solid cash reserves (EUR144 million at end-Q1 2014), though generated cash flows are expected to decline due to the reduction in allowed returns. The company's liquidity position is further underpinned by an undrawn EUR600 million back-up revolving credit facility (RCF) maturing in Q2 2019 (with the option to extend to 2021). The repayment profile is manageable with EUR850 million of outstanding shareholder loans maturing in 2016 and 2019 and the first bond (EUR500 million) maturing in 2020.

Rating Outlook

The stable outlook reflects our 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. This further assumes that the proposed asset swap with Alliander would be transacted at a rate that does not materially impair financial ratios.

What Could Change the Rating - Up

An upgrade of the final rating is considered unlikely. Given the latest regulatory settlement we expect the financial profile to deteriorate due to the reduction in the allowed return and ongoing investment requirements.

What Could Change the Rating - Down

For Enexis to remain safely positioned within its current BCA of a2, we would expect the company 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 in the mid to high teens.

Rating Factors

Enexis Holding N.V.

Regulated Electric and Gas Networks [1][2]	**Current As at 12/31/2013**			[3]**Moody's 12-18 Month Forward ViewAs of 1 August 2014**	
Factor 1: Regulatory Environment & Asset Ownership Model (40%)					
a) Stability and Predictability of Regulatory Regime		Aa			Aa
b) Asset Ownership Model		Aa			Aa

c) Cost and Investment Recovery		A		A
d) Revenue Risk		Aa		Aa
Factor 2: Efficiency & Execution Risk (10%)				
a) Cost Efficiency		Baa		Baa
b) Scale and Complexity of Capital Programme		Baa		Baa
Factor 3: Stability of Business Model & Financial Structure (10%)				
a) Ability and Willingness to Pursue Opportunistic Corporate Activity		A		A
b) Ability and Willingness to Increase Leverage		Baa		Baa
c) Targeted Proportion of Operating Profit Outside Core Regulated Activities		A		A
Factor 4: Key Credit Metrics (40%)				
a) FFO Interest Cover Ratio (3 Year Avg)	6.1x	Aa	6.5x - 7x	Aa
b) Net Debt / fixed assets (3 Year Avg)	32.1%	Aa	30% - 35%	Aa
c) FFO / Net Debt (3 Year Avg)	31.2%	Aaa	25% - 30%	Aa
d) RCF / CAPEX (3 Year Avg)	1.0x	Ba	0.5x - 1x	Ba
Rating:				
a) Indicated Rating from Grid factors 1-4		A1		A1
b) Impact from Rating Uplift	0		0	
c) Indicated Rating from Grid		A1		A1
d) Actual Rating Assigned (BCA)		a2		a2

Government-Related Issuer	Factor	Factor
a) Baseline Credit Assessment	a2	a2
b) Government Local Currency Rating	Aaa	Aaa
c) Default Dependence	Very High	Very High
d) Support	Strong	Strong

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2013; Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.