MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Enexis Holding N.V.'s Aa3/P-1 ratings; outlook stable

14 Feb 2022

London, 14 February 2022 -- Moody's Investors Service ("Moody's") has today affirmed Enexis Holding N.V.'s (Enexis) long-term issuer ratings and senior unsecured debt ratings at Aa3. Enexis' senior unsecured MTN program rating was also affirmed at (P)Aa3. Concurrently, the rating agency affirmed the Prime-1 short-term issuer rating and the a2 Baseline Credit Assessment (BCA). The outlook remains stable.

The rating affirmation follows the publication of the final regulatory decision for electricity and gas distribution networks in the Netherlands on 20 September 2021, [1] in which the regulator proposes a significant cut in allowed return in real terms for the 2022-26 regulatory period. It also takes into account consideration by the Dutch government to provide additional support for investments necessary to facilitate the country's energy transition, as indicated in a presentation to new ministers by the Ministry of Economy in January 2022. [2]

RATINGS RATIONALE

RATIONALE FOR RATINGS AFFIRMATION

Today's rating affirmation reflects (1) the low business risk of Enexis' monopoly operation of domestic electricity and gas distribution, which generates more than 90% of the company's earnings and cash flow; (2) a well-defined and transparent regulatory framework; and (3) the company's balanced financial profile, with relatively modest leverage for the sector, and robust liquidity. The Aa3 rating also incorporates a two-notch uplift from Enexis' standalone credit quality, represented as an a2 baseline credit assessment (BCA). The uplift from the company's BCA takes into account the likelihood of extraordinary financial support by its owners — the largest of which is the Province of Noord-Brabant, holding around 31% of Enexis' shares — if needed.

The rating affirmation also considers the final decisions for the 2022-26 regulatory period, published by the Authority for Consumers & Markets (ACM) in September 2021, as well as the country's decarbonisation strategy and associated investment requirement over the coming five to ten years. In that context, Moody's also took account of the potential for additional equity support to underpin credit quality in the context of growing investment needs.

Under the ACM's final determination for the 2022-26 period, allowed returns, on a comparable basis (pre-tax, real) fell by around 180 basis points between 2021 (3.0%) and 2022 (1.15% for distribution network operators), mostly reflecting the low interest rate environment.

However, gas network operators will receive advanced cash flows because the regulator switched from real to nominal returns, with nominal returns in 2022 expected to be around 2.9%. Depreciation of gas network assets was accelerated (by a factor of 1.2x for the distribution companies, compared with 1.3x for the gas transmission network) because of the uncertainty around the remaining useful life of the gas network assets, and the regulator also allowed recovery for network decommissioning costs (if these costs occur, via subsequent calculation and a recovery after two years).

For electricity distribution network operators, 50% of the forecast inflation will be added to the real return, while the regulated asset base will inflate with the remaining 50%, such that cash returns will likely amount to around 2.0% in 2022.

While these measures increase cash returns, allowed returns will likely fall over the period if interest rates remain low, as the cost of debt is updated annually, based on an index of utility issuances.

Moody's estimates that the methodology changes would provide additional funds from operations (FFO) of between EUR80-100 million per year for Enexis and could improve FFO to net debt by ca. 2.5 percentage points on average over the period compared with the prior regulatory approach. However, the allowed equity return for Dutch network operators is also among the lowest across the European regulatory frameworks because the ACM places more weight on short-term averages in determining the risk-free rate.

The overall low return will generally put pressure on Enexis' FFO over the period to 2026, particular as investments are likely to grow significantly over that period. In June 2019, the Dutch Government adopted the Dutch Climate Agreement which commits the Netherlands to (1) a 49% reduction in CO2 emissions relative to 1990 levels and the generation of 70% of electricity by renewable energy sources by 2030; and (2) a 95% reduction in CO2 emissions relative to 1990 levels and the generation of all electricity carbon neutrally by 2050. Delivering these targets will require a significant acceleration of the energy transition across many areas that would result in material incremental capital spending for the Dutch networks, including new connections for local renewable generation (primarily solar and onshore wind), reinforcing the grid to cope with the growth in electric vehicles and heat transition.

Under Moody's base case, Enexis' FFO/net debt metric would fall towards the mid-teens in percentage terms, the minimum required for the current rating, in the later years of the current period. Higher than forecast investment requirements could increase the pressure on this metric unless offset by balance sheet strengthening measures, which could include additional equity. In this context, the rating affirmation reflects the Dutch government's intention to "provide sufficient capital for network operators" to facilitate the national decabonisation strategy. Although the exact form of potential additional support remains unclear, it is possible that new central government funds will be provided if necessary, as outlined by the Ministry of Economy earlier this year.

RATING OUTLOOK

The stable outlook reflects Moody's expectation that Enexis will continue to derive most of its revenue and cash flow from low-risk regulated activities and maintain a financial profile in line with the minimum guidance for the current rating as outlined below.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

A rating upgrade is unlikely considering the decrease in allowed returns amid growing capital investment requirements in the context of the country's energy transition.

Conversely, a rating downgrade could be triggered if Enexis failed to maintain minimum credit metrics for its current ratings, including FFO/net debt persistently below 16% and net debt/fixed assets not materially above 50%.

The Aa3 rating could also be subject to downward pressure if the credit quality of the municipalities and provinces owning Enexis were to significantly deteriorate or if Moody's assessment of extraordinary support weakened.

PRINCIPAL METHODOLOGIES

The methodologies used in these ratings were Government-Related Issuers Methodology published in February 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1186207, and Regulated Electric and Gas Networks published in March 2017 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1059225 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

Enexis Holding N.V. (Enexis) is a holding company of Enexis Netbeheer B.V. (previously Enexis B.V.), which provides the regulated activities of owning and managing the gas and electricity distribution networks in several Dutch regions, covering around 31% of the country. The group's regulated activities generate more than 95% of revenue and represent around 90% of the group assets. The Enexis group is one of the three largest electricity and gas distribution network operators in the Netherlands, responsible for the maintenance, management and development of the medium-voltage electricity and gas distribution grids. It operates around 142,200 kilometres (km) of electricity cables and 46,300 km of gas pipelines, delivering electricity to around 2.9 million customers and gas to 2.3 million customers.

Enexis is owned by the five Dutch provinces (together owning 75.6%; Noord-Brabant (31%), Overijssel (20%), Limburg (16%), Groningen (7%) and Drenthe (2%)) and 88 municipalities (24.4%) of its service area.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?

docid=PBC_79004.

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REFERENCES/CITATIONS

[1] https://www.acm.nl/nl/publicaties/methodebesluit-regionaal-netbeheer-elektriciteit-2022-2026

and https://www.acm.nl/nl/publicaties/methodebesluit-regionaal-netbeheer-gas-2022-2026

[2] https://www.rijksoverheid.nl/documenten/richtlijnen/2022/01/10/introductiedossier-bewindspersonen-ministerie-van-ezk

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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